Supreme Court, U.S.
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No. 06-669

IN THE
Supreme Court of the United States

VERITY INTERNATIONAL, LTD.,
AUTOMATIC COMMUNICATIONS, LTD.,
ROBERT GREEN, and MARILYN SHEIN,

Petitioners,

v.

FEDERAL TRADE COMMISSION,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the exclusion in 15 U.S.C. § 45(a) (2) of "common carriers subject to the Acts to regulate commerce" from the jurisdiction of the Federal Trade Commission ("FTC") bars an FTC lawsuit against a company that has the status of a common carrier because it has been licensed by the Federal Communications Commission ("FCC") and has filed a tariff even if the company's "activities" challenged by the FTC are not subject to regulation under the Federal Communications Act.

2. Whether the Federal Communications Commission has "primary jurisdiction" over a civil action to enjoin telephone billing practices based on "automatic number identification" ("ANI") in which the court is asked (a) to decide whether the provider is engaged in "telecommunications services" or "information services" and (b) to rule on other complex and novel issues of telecommunications policy.

3. Whether a billing system for telephone subscribers requiring them to pay filed rates is deceptive because it bills them for services concededly obtained using their home telephone lines even if they do not personally authorize each use of such telephone line.

LIST OF PARTIES

The caption of the case on the cover page includes all active parties in the court whose judgment is the subject of this petition. Integretel, Inc., EBillit, Inc., and AT&T Corp. were defendants and a third-party defendant in the district court but were not parties to the appeal.

CORPORATE DISCLOSURE STATEMENT

Verity International, Ltd., and Automatic Communications, Ltd. have no parent corporation. No publicly held company owns 10% or more of the stock of either corporation.

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VERITY INTERNATIONAL, LTD.,
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ROBERT GREEN, and MARILYN SHEIN,

Petitioners,

v.

FEDERAL TRADE COMMISSION,

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On Petition for Writ of Certiorari to the
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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A, pp. 1a - 38a, *infra*) is reported at 443 F.3d 48 (2d Cir. 2006). An opinion of the district court denying petitioners' motion to dismiss (Pet. App. C, pp 80a – 110a, *infra*) is reported at 194 F. Supp. 2d 270 (S.D.N.Y. 2002). An opinion of the district court granting the Federal Trade Commission's motion for a preliminary injunction (Pet. App. D, pp. 111a – 138a, *infra*) is reported at 124 F. Supp. 2d 193 (S.D.N.Y. 2000). An

opinion of the district court granting final judgment for the Federal Trade Commission (Pet. App. B, pp. 39a – 79a, *infra*) is reported at 335 F. Supp. 2d 479 (S.D.N.Y. 2004).

JURISDICTION

The court of appeals' judgment was entered on March 27, 2006. A timely petition for rehearing was denied on June 14, 2006 (Pet. App. E, pp. 139a – 140a, *infra*). On August 30, 2006, Justice Ginsburg extended the time for filing a petition for a writ of certiorari to and including November 11, 2006. The jurisdiction of this Court rests on 28 U.S.C. § 1254.

STATUTORY PROVISIONS INVOLVED

Section 5(a)(2) of the Federal Trade Commission Act of 1914, as amended, 15 U.S.C. § 45(a)(2), provides as follows:

> **§ 45. Unfair methods of competition unlawful; prevention by Commission**
>
> **(a) Declaration of unlawfulness; power to prohibit unfair practices; inapplicability to foreign trade**
>
> * * * * *
>
> (2) The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, except banks, savings and loan institutions described in section 57a(f)(3) of this title, Federal credit unions described in section 57a(f)(4) of this title, common carriers

> subject to the Acts to regulate commerce, air carriers and foreign air carriers subject to part A of subtitle VII of Title 49, and persons, partnerships, or corporations insofar as they are subject to the Packers and Stockyard Acts, 1921, as amended [7 U.S.C.A. § 181 *et seq.*], except as provided in section 406(b) of said Act [7 U.S.C.A. § 227(b)], from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.

Section 6(a) of the Federal Trade Commission Act of 1914, as amended, 15 U.S.C. § 46(a), provides as follows:

> **§ 46. Additional powers of Commission**
> The Commission shall also have power--
> **(a) Investigation of persons, partnerships, or corporations**
> To gather and compile information concerning, and to investigate from time to time the organization, business, conduct, practices, and management of any person, partnership, or corporation engaged in or whose business affects commerce, excepting banks, savings and loan institutions described in section 57a(f)(3) of this title, Federal credit unions described in section 57a(f)(4) of this title, and common carriers subject to the Act to regulate commerce, and its relation to other persons, partnerships, and corporations.

STATEMENT

1. Introduction

This case concerns the authority of the Federal Trade Commission ("FTC") to proceed in a United States District Court against a corporation that was licensed by the Federal Communications Commission ("FCC") as a "common carrier" under the Communications Act and thereafter filed a tariff with the FCC. The FTC alleged in its federal-court complaint that the petitioners engaged in unfair and deceptive trade practices under Section 5(a) of the FTC Act when it caused telephone-line subscribers to be billed for international telephone calls at the applicable tariffed rates.

The courts below rejected the petitioners' contentions that (1) the FTC lacked jurisdiction to proceed against a company that the FCC had licensed as a "common carrier;" and (2) that the FCC had "primary jurisdiction" over the allegation that the carriers' billing practices were deceptive. The lower courts also overruled petitioners' claim that the billing practices were insulated from challenge by the "filed-rate doctrine," and they found that the billing of line subscribers was deceptive because the bills implicitly made a false representation that the line subscribers were obligated to pay international toll charges for calls made using their home telephones. The FTC's legal theory, accepted by the courts below, was that line subscribers could lawfully be charged only if they had personally authorized the billed calls.

2. The Petitioners

Robert Green and Marilyn Shein are citizens of the United Kingdom who are founders and principals of Automatic Communications, Ltd. ("ACL") and Verity International, Ltd. ("Verity"), incorporated in the Bahamas (p. 8a, *infra*). The relationship among the corporate petitioners, AT&T, Sprint, and eBillit, Inc. ("eBillit"), which billed the subscribers for calls carried by Sprint, is described in the opinions of the lower courts. *See* pp. 4a – 7a and pp. 46a – 58a, *infra*. Briefly summarized, petitioner ACL contracted with (a) Telecom Malagasy, the national telephone company in Madagascar, for the exclusive right to terminate calls to a block of numbers assigned to Madagascar; and (b) AT&T, AT&T U.K. (now Viatel), and Sprint, to carry calls between American consumers and the Madagascar numbers. By separate agreement, ACL's Madagascar telephone numbers were subsequently included in a "dialer" service offered to any interested website host or owner by Global Internet Billing ("GIB") – an entity unrelated to the petitioners.

Consumers who opened the webpage of a website that used GIB's dialer service were presented with a "disclosure page" advising them that if they clicked on an "I accept" button, they would be charged a standard disclosed per-minute fee by the designated long-distance carrier (initially AT&T, then Sprint) for the international call needed to connect to the website. Consumers who clicked "I accept" thereby activated GIB's dialer program so that calls that accessed the website were routed to AT&T or Sprint to complete the connection. The FTC did not challenge the

sufficiency of these disclosures, all of which were made by GIB or the website operators.

The long-distance carrier handling the connection (AT&T or Sprint) recorded the information required for "automatic number identification" ("ANI") billing -- the number from which the call was made, the number dialed by the user, and the duration of the call. AT&T or eBillit (for calls carried by Sprint) then used that information to generate the bills to consumers for toll charges due the carriers for those international calls.

Neither AT&T nor eBillit had any means to determine the identity of the individuals initiating these international calls using subscribers' home computers. It was undisputed below that (a) the subscribers were only billed for actual calls made from their home computers to the Madagascar numbers, (b) the subscribers were billed at the FCC-tariffed rates due AT&T or Sprint for these international calls, and (c) petitioners had no financial or other interest in GIB or any of the adult-content websites.

In November 1999 ACL applied to the FCC for authority under Section 214 of the Communications Act of 1934, 47 U.S.C. § 214, to become a resale-based international common carrier. *See* Ex. 113, Joint Appendix A-6244 – A-6249. ACL's application to be a "global international reseller" of communications services was granted on December 8, 1999. *See* FCC Public Notice, December 9, 1999. Joint Appendix A-7186 – A-7187. On September 7, 2000, ACL filed with the FCC a 62-page

"Telecommunications Services Tariff" to take effect on September 11, 2000. Exhibit 113.

3. The FTC's Lawsuit

The FTC filed its initial complaint on October 2, 2000, alleging that it was false and deceptive to represent that the line subscribers are legally obligated to pay for the calls made to gain access to the adult-content website unless the line subscribers personally authorized use of their home computers to make those calls. The district court granted an immediate temporary restraining order against the billing practices and froze the corporate petitioners' assets. On December 13, 2000, the district court granted the FTC's request for a preliminary injunction. *See* Pet. App. D, pp. 111a – 138a, *infra.*

Petitioners filed a motion for judgment on the pleadings on May 30, 2001, asserting that the FTC lacked jurisdiction under Section 5(a)(2) of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(2), and that the FCC had primary jurisdiction. The district court then sought the opinion of the FCC as *amicus curiae* on four questions relating to its jurisdiction:

1. Is ACL a common carrier within the meaning of the Communications Act of 1934, as amended?
2. Assuming that it is, are its alleged activities with respect to which the Federal Trade Commission seeks relief in this action exempt

from the Federal Trade Commission Act (the "Act")

3. Should the Court dismiss or stay all or any part of the action in favor of the FCC under the doctrine of primary jurisdiction?
4. Does the filed rate doctrine bar all or any part of this action?

An Assistant United States Attorney submitted a letter response to the district court on behalf of the FCC. App. F, pp.141a – 149a, *infra*. The letter reported the FCC's opinion that ACL's "activities" were not "common carrier activities," but did not address ACL's status as a common carrier and took no position on the application of Section 5(a)(2) of the FTC Act.

The district court then denied the petitioners' motion. Pet. App. C, pp. 80a – 110a *infra*. The district court acknowledged that ACL had been licensed by the FCC as a "common carrier" and that it was a common carrier "for some purposes," but found that its contractual arrangements that resulted in the billings for the adult-content website access were "extraneous activities." On the ground that the defendant's "activities" rather than its "status" controlled the FTC's jurisdiction, the district court denied the motion to dismiss. The district court recognized that the Seventh Circuit had held "otherwise" in *Federal Trade Commission v. Miller*, 549 F.2d 452 (7th Cir. 1977), but it found *Miller* (and an earlier Second Circuit opinion that had approved *Miller*) not "persuasive." *See* pp. 85a – 87a, *infra*.

After the district court denied both sides' motions for summary judgment in July and August 2002, a bench trial was held on a stipulated record. With an opinion dated September 17, 2004, the district court entered a permanent injunction and a joint-and-several judgment against all petitioners in the amount of $17.9 million on the ground that that amount constituted restitution of the total paid by consumers.

4. The Court of Appeals' Decision

The court of appeals affirmed the injunction, but vacated the money judgment (and a contempt sanction that the district court had entered against the individual petitioners). *See* pp. 29a – 38a, *infra.* The court of appeals did not address the conflict with the Seventh Circuit's opinion in *Miller*, although the briefs of both parties had cited and discussed that case. Instead, the court of appeals declared that ACL was not a "common carrier" because "conceptually" it was a "foreign terminating carrier" that was not subject to the Communications Act and, in the view of the court of appeals, "it never itself carried any calls." *See* p. 16a, *infra.* As for the license granted to ACL by the FCC, the court of appeals held that it only authorized ACL to "become" a common carrier and "did not alone make the entity a common carrier." *See* p. 17a, *infra.*

The court of appeals also rejected the petitioners' claim that the FCC had primary jurisdiction over this controversy on the ground that no special expertise of the FCC was involved in resolving the relevant issues. *See* pp. 18a – 20a, *infra.* As for petitioners' contention that

subscribers were required to pay for calls made using their lines under the "filed-rate doctrine," the court of appeals held that since access to the adult-content websites was provided in addition to the telephone service, the "filed-rate doctrine" did not apply. *See* pp. 20a – 23a *infra.* Finally, the court of appeals held that the "representation of uncontestability" in the bills that petitioners caused AT&T and eBillit to send to subscribers was deceptive. *See* pp. 23a – 27a, *infra.*

REASONS FOR GRANTING THE WRIT

A. The Second Circuit's Decision Permitting the FTC To Sue a Licensed "Common Carrier" Conflicts With an Important Seventh Circuit Precedent That Has Been Followed by Other Federal Courts.

The district court candidly acknowledged that the position taken by the FTC in bringing this proceeding against an entity that had the "status" of a "common carrier" because it was an FCC licensee was contrary to the Seventh Circuit's decision in *Federal Trade Commission v. Miller*, 549 F.2d 452 (7th Cir. 1977). The Seventh Circuit held in *Miller* that the FTC lacked jurisdiction under 15 U.S.C. § 45(a)(2) to proceed – even by investigation alone – against a company that has the "status" of a "common carrier" under "Acts to regulate commerce." It is undisputed that the Communications Act of 1934 is an "Act to regulate commerce," and that ACL applied for a license, submitted a tariff, and actually performed services involving international telecommunications. By the standard of the *Miller* case, ACL is plainly beyond the jurisdiction of the

FTC regardless of the nature of the particular activities involved in this case because it has the "status" of a common carrier.

The FTC itself has recently relied on the *Miller* rule that the "status" of an entity, not its activities, controls a respondent's exemption under 15 U.S.C. § 45(a) (2). In *National Federation of the Blind v. Federal Trade Commission*, 303 F. Supp. 2d 707 (D. Md. 2004), *aff'd*, 420 F.3d 331 (4th Cir. 2005), *cert. denied*, 126 S. Ct. 2058 (2006), the district court said, citing *Miller* (303 F. Supp.2d at 714-715) (emphasis original):

> The FTC's interpretation of the statutes at issue is bolstered by case law regarding the jurisdiction of the FTC. Courts have held that an entity's exemption from FTC jurisdiction is based on that entity's *status*, not its activity.

The Eighth Circuit cited and relied on the "status" criterion articulated in *Miller* in *Blue Ribbon Quality Meats, Inc. v. Federal Trade Commission*, 560 F.2d 874, 877 n.2 (8th Cir. 1977), and in *Federal Trade Commission v. Winters National Bank & Trust Co.*, 601 F.2d 395, 401 (8th Cir. 1979). The District of Columbia Circuit also discussed the *Miller* holding approvingly in *Federal Trade Commission v. Ernstthal*, 607 F.2d 488, 491-93 (D.C. Cir. 1979), although it reserved the question whether it would approve the *Miller* principle as applied to FTC *investigations*. Federal district courts have also relied on the Seventh Circuit's *Miller* decision. *See Federal Trade Commission v. Am. Standard*

Credit Sys., Inc., 874 F. Supp. 1080, 1086 (C.D. Cal. 1994); *Federal Trade Commission v. Manufacturers Hanover Consumer Services, Inc.*, 543 F. Supp. 1071, 1074 (E.D. Pa. 1982); *A & B Freight Lines, Inc. v. Federal Trade Commission*, 1980-1 Trade Cas. (CCH) ¶ 63,127, 1980 WL 1787 (D.D.C. 1980).

Even the Second Circuit – before the decision in this case which totally ignored *Miller* – expressed its agreement with *Miller*. In *Official Airline Guides, Inc. v. Federal Trade Commission*, 630 F.2d 920 (2d Cir. 1980), Circuit Judge Oakes quoted approvingly the language in the *Miller* decision that held that the jurisdictional exemption in the FTC Act "is in terms of status as a common carrier subject to the Interstate Commerce Act, not activities subject to regulation under that Act." 630 F.2d at 923 (quoting *Miller*, 549 F.2d at 455). The Second Circuit decision in this case studiously avoided both *Miller* and *Official Airline Guides*.

The proposition on which the court of appeals relied in this case as sustaining the FTC's jurisdiction notwithstanding the plain language of 15 U.S.C. § 45(a)(2) and the *Miller* precedent was that ACL was not a "common carrier" because it was "a purely foreign terminating carrier at the conceptual level." *See* p. 16a, *infra*. ACL was, however, a common carrier that provided a "telecommunications service" as defined by 47 U.S.C. § 153(43) with no change in the form or content of the transmitted information. Nor is there substance to the court of appeals' assertion that the license granted to ACL made it only a *potential* common carrier. ACL was actually engaged

in common carriage, and its status as a common carrier was established by its license and filed tariff.

The Seventh Circuit's precedent in *Miller* rests on the "plain language" of Section 45(a)(2) which removes "common carriers" like ACL from the jurisdiction of the FTC. In enacting the FTC Act, Congress determined that "common carriers" in interstate industries covered by federal regulatory statutes should be regulated by, and subject to the jurisdiction of, the federal agencies that license them and not subjected to independent or overlapping enforcement by the FTC.

The *Miller* decision's exemption from the FTC Act for entities that have the "status" of common carriers has been important and pervasive enough that it should not be undermined by unsupportable distinctions such as those offered in the opinions of the courts below. This Court should grant plenary review in this case to determine whether the Seventh Circuit's decision in *Miller* – followed and cited approvingly by other federal courts until the decision in this case, and even relied on by the FTC -- is correct and whether it should have been applied to the FTC's action against the petitioners.

B. The Second Circuit's Decision Conflicts With This Court's Rulings Regarding the "Primary Jurisdiction" of Federal Agencies and With This Court's Recent Deference to the FCC in Defining "Telecommunication Services."

Subscribers were billed by AT&T (and, for calls carried by Sprint, by eBillit) on the basis of "automatic number identification" ("ANI"). The carrier handling the telephone call recorded, *inter alia*, (a) the number from which the call was made, (b) the number dialed by the user, and (c) the duration of the call. Using that data, the carrier billed the line's subscriber for the services dialed from the subscriber's telephone. No mechanism exists for determining whether the subscriber "authorized" use of his telephone line, and, as a practical matter, a carrier can *never* know who is at a computer keyboard seeking Internet access using a telephone modem hook-up.

The district court acknowledged that the key issue in this case was whether ANI billing was deceptive. *See* Pet. App. B, pp., 64a, 66a, 69a, *infra.* In addition, the district court had to decide whether the services provided by the petitioners were "telecommunication services" or "information services." The line between a "telecommunications service" and an "information service" – which the district court purported to apply to the facts of this case (*see* Pet. App. B, p. 67a, *infra*) – is a line that this Court has remitted to the expertise of the FCC. *Nat'l Cable & Telecommunications Ass'n v. Brand X Internet Servs.*, 544 U.S. 967 (2005).

These were questions that call for the expertise and judgment of the agency charged with the responsibility of administering the Federal Communications Act. Congress was "well aware that the ambiguities it [chose] to produce [in the Act] will be resolved by the implementing agency," *AT&T Co. v. Iowa Utils. Bd.*, 525 U.S. 366, 397 (1999), and Congress therefore delegated to the FCC the "authority to fill gaps where the statutes are silent." *Nat'l Cable & Telecom. Ass'n v. Gulf Power Co.*, 534 U.S. 327, 338-39 (2002).

ANI billing is widely used throughout the telecommunications industry and it involves billions of dollars of annual revenue to telecommunications carriers for transporting calls containing videotext communications. Invalidating ANI billing – as the FTC essentially requested in this case and as the courts below agreed – jeopardizes a practice that has been uniformly relied on by the entire industry. The FCC should make the judgment whether such a result is consistent with national telecommunications policy, and the district court should have deferred any decision until the FCC had an opportunity to consider the issues in a contested adversary context.

A letter was submitted to the district court expressing conclusions stated on behalf of the FCC without any consideration by the agency of adversary presentations. The letter did not address policy issues raised by the FTC's contention that ANI billing by a telecommunications carrier is inherently deceptive and unfair because subscribers may be billed for use of their telephone lines that they did not personally authorize. The opinions expressed in the letter concerned only whether ACL's "activities" constituted

"common carrier service to the public." Nor were those opinions conclusions reached by the agency on the basis of plenary consideration, and they do not determine the primary-jurisdiction issue. This Court has defined the boundaries of the primary-jurisdiction doctrine. *E.g., Reiter v. Cooper,* 507 U.S. 258, 268 (1993); *United States v. Western Pac. R.R. Co.,* 352 U.S. 59, 63-64 (1956). It does not depend on the *ad hoc* judgment of the federal agency whose jurisdiction is invoked in a particular case as reported by an Assistant United States Attorney.

C. The Lower Courts' Decisions That Petitioners' Billing Practices Were Deceptive Conflict With the "Filed Rate" Doctrine.

This Court first applied the "filed tariff" doctrine in *Keogh v. Chicago & Northwestern Railway. Co.*, 260 U.S. 156 (1922), in order to prevent discriminatory pricing by common carriers. It was subsequently incorporated into the Communications Act of 1934. *See* 47 U.S.C. § 203. In *AT&T Co. v. Central Office Telephone, Inc.,* 524 U.S. 214, 222 (1998), this Court referred to it as "the century-old filed rate doctrine" and held it applicable to telecommunications carriers.

The doctrine holds that where an agency has reviewed and filed a tariff, the tariffed prices and terms become binding without exception on consumers and on the common carrier. 524 U.S. at 223. The doctrine is applied rigidly irrespective of equitable considerations. *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.,* 497 U.S. 116, 127 (1990). This Court said in the *Central Office* case that the

rights and liabilities defined by the tariff "cannot be varied or enlarged by either contract or tort of the carrier" and that the doctrine extends to "service, provisioning, and billing options." 524 U.S. at 224.

The subscribers in this case were charged the filed AT&T and Sprint tariffs for services that were indisputably provided. The only ground alleged by the FTC as to why subscribers were not required to pay for these services was that subscribers claimed that they had not authorized the challenged calls. The petitioners were accused of engaging in a deceptive practice because they relied on the "filed rate" doctrine to hold subscribers liable for calls made on their lines. That result conflicts with the doctrine that this Court articulated and has applied repeatedly.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

November 2006

Respectfully submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket No. 04-5487-CV

FEDERAL TRADE COMMISSION,

Plaintiff-Appellee,

v.

VERITY INTERNATIONAL, LTD.,

Defendant-Appellant,

AUTOMATIC COMMUNICATIONS, LTD.; ROBERT GREEN, Individually and as Owner of Verity International, Ltd.; MARILYN SHEIN, Individually and as Owner of Verity International, Ltd.,

Defendants-Third-Party-Plaintiffs-Appellants,

INTEGRETEL, INC., a California corporation;; EBILLIT, INC., a subsidiary of Integretel, Inc.,

Defendants,

AT&T CORP.,

Third-Party-Defendant.

Argued: October 7, 2005
Decided: March 27, 2006

Before: WALKER, Chief Judge, FEINBERG and STRAUB, Circuit Judges.

JOHN M. WALKER, JR., Chief Judge.

The incessant demand for pornography, some have said, is an engine of technological development. John Tierney, *Porn, the Low-Slung Engine of Progress,* N.Y. Times, Jan. 9, 1994, § 2 (Arts & Leisure Desk), at 1 (noting as an example new pay-per-call technology). The telephonic system at dispute in this appeal is an example of that phenomenon–it was designed and implemented to ensure that consumers paid charges for accessing pornography and other adult entertainment. The system identified the user of an online adult-entertainment service by the telephone line used to access that service and then billed the telephone-line subscriber for the cost of that service as if it was a charge for an international phone call to Madagascar. *52 This system had the benefit that the user's credit card never had to be processed, but it had a problem as well: It was possible for someone to access an adult-entertainment service over a telephone line without authorization from the telephone-line subscriber who understood herself contractually bound to pay all telephone charges, including those that disguised fees for the adult entertainment.

The Federal Trade Commission ("FTC") took a dim view of this billing system and brought suit to shut it down as a deceptive and unfair trade practice within the meaning of § 5(a)(1) of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45(a)(1). The FTC sued Verity International, Ltd. ("Verity") and Automatic Communications, Ltd. ("ACL"), corporations that operated this billing system, as well as Robert Green and Marilyn Shein, who controlled these corporations during the relevant time period. These four defendants appeal from the district court's decision and judgment finding them liable for violating § 5(a)(1). Green and Shein also appeal from a district court order holding them in contempt of court.

BACKGROUND

The district court found the following facts upon a bench trial.

I. Structure of the Billing System

The defendants-appellants' billing system operated as follows: When a computer user visited a website providing adult-entertainment services, the website offered the user the ability to buy adult content using a downloadable "dialer program." The user downloaded the dialer program after clicking through a series of website disclosures containing the terms and conditions of use and an explanation that charges for the adult content would be billed to the telephone-line subscriber as the cost of an international phone call. The computer user then initiated the dialer program, and if the computer was connected by modem to a telephone line, the dialer program placed an international phone call to a Madagascar telephone number, bypassing the line subscriber's designated carrier in favor of AT&T and later Sprint.

Either AT&T or Sprint carried the call to London where it handed off the call to a separate carrier, AT&T U.K. (later renamed Viatel). Instead of routing the call to Madagascar for completion, AT&T U.K./Viatel carried the call to a designated internet server in the United Kingdom, a practice known as "short-stopping" the call. That internet server finalized the connection between the user's computer and the website providing the desired adult entertainment.

Charges for accessing the adult entertainment appeared on bills sent to the consumers whose telephone lines were used. AT&T and Sprint identified the telephone-line subscribers by the Automatic Number Identification ("ANI") system, the standard means by which telephone companies bill for phone calls. These bills, at first telephone bills from AT&T and later

separate bills designed by Verity and sent using information provided by Sprint, charged line subscribers for long-distance phone calls to Madagascar.

Notably, this billing system did not have a mechanism to ensure that a telephone-line subscriber authorized the computer user to access a given adult-entertainment service. The absence of such a mechanism allowed line subscribers to receive bills for adult-entertainment access about which they had no knowledge, which prompted the FTC to bring this lawsuit.

II. Creation and Operation of the Billing System

In May 1997, defendant-appellant ACL contracted with Telecom Malagasy, the national *53 telecommunications carrier for Madagascar, for (1) the right to carry calls placed to certain international telephone numbers assigned to Madagascar, (2) the right to collect charges for these calls, and (3) the right to terminate these calls at any location of ACL's choice, including locations outside Madagascar. The right to carry calls to these numbers was valuable because of the calls' high per-minute tariffed rate under U.S. telecommunications law. Revenue generated from these calls would ultimately be divided between ACL, Telecom Malagasy, various phone-call carriers, ACL's billing agents, a company that distributed the dialer program mentioned above, and various adult-website operators.

To exploit ACL's right to carry calls to these Madagascar phone numbers, ACL contracted with Global Internet Billing, Inc. ("GIB") for GIB to market the dialer program to adult-website operators and to use its best efforts to generate a minimum usage volume. ACL agreed to provide GIB with the Madagascar telephone numbers for inclusion in GIB's dialer program. ACL paid a portion of call revenues to GIB, which in turn paid the adult-website operators, effectively making GIB a paid intermediary between ACL and the website operators.

ACL also needed to arrange for the carriage of calls from a computer's modem to the U.K. internet servers that would connect the calling computer to an adult website in the United States. Accordingly, in January 1999, ACL contracted with two companies, AT&T and AT&T U.K., to carry the calls. AT&T agreed to carry calls placed to ACL's Madagascar phone numbers to the London facilities of AT&T U.K. AT&T U.K. would then carry the calls to the designated U.K. internet servers. AT&T was responsible for billing and collection for these calls, and using ANI information, AT&T billed phone-line subscribers for the ACL calls on their regular monthly telephone statements.

The content of the telephone statements received by the subscribers is relevant here. AT&T charged subscribers only the tariffed rates for phone calls to Madagascar. It listed the charges in the "Long Distance" section of the bills, with Madagascar as the "Place Called." Under the "Important Information" header, the bills stated that "nonpayment of toll charges may result in disconnection of local service, and other services may be restricted if not paid."

In the roughly-seven-month period beginning in January 2000, when adult-website operators started using ACL's system to provide adult-entertainment services to computer users, AT&T's billings for traffic to ACL's Madagascar numbers totaled $29 million, as compared to $1.6 million in total billings during the previous twelve months. At the same time, the percentage of total billings refunded to subscribers who contested their bills spiked from 8% in the previous year to 38% during this period.

ACL's contract with AT&T, together with ACL's other agreements, established a multitiered cascading-payment structure: AT&T sent to AT&T U.K. the amounts due both AT&T U.K. and ACL; AT&T U.K. then paid ACL from those

funds. ACL then paid GIB, who in turn paid the adult-website operators. Each entity kept some of the money along the way. (Telecom Malagasy was compensated separately by both AT&T and ACL for providing the phone numbers.) This arrangement was in effect from January 2000 until July 2000, when AT&T terminated the contract and stopped carrying calls for ACL. The district court deemed this the "AT&T Period."

*54 After AT&T terminated the agreement, ACL turned to Sprint as a replacement. ACL reached an agreement with Sprint which contemplated Sprint performing billing and collection functions, as AT&T did, but Sprint then quickly entered into a new agreement that released it from these duties. Under the new agreement, Sprint agreed to carry calls to the London facilities of AT&T U.K. (now renamed Viatel), but it would leave billing and collection to ACL by providing ACL with the ANI information identifying the subscribers whose telephone lines were used to call ACL's Madagascar numbers. As it did in the AT&T agreement, ACL warranted that it would receive the calls and terminate them in Madagascar. ACL agreed to pay a per-minute fee to Sprint and AT&T U.K./Viatel for serving as carriers of the phone calls. This "Sprint Period" lasted from July 2000 through September 2000, when Sprint stopped carrying calls to ACL's Madagascar phone numbers.

To handle billing and collection during the Sprint Period, ACL entered into an agreement, in Verity's name, with eBillit, Inc., a subsidiary of Integretel, Inc. The agreement required eBillit to prepare and mail bills to line subscribers, collect payments from them, and handle their complaints. The eBillit bills were branded with the Verity logo and were separate from the line subscribers' regular telephone bills. These Verity bills contained an invoice number, an account number, the subscriber's telephone number, a summary of charges, a due date, and a statement in capital letters that "this bill accounts for international calls, from your modem to a Madagascar number,

for website access." The bills contained a "Detail of Charges" section in which the city called was listed as one of several cities within Madagascar. Defendant-appellant Robert Green approved the format of these bills.

The bills also contained a "1-800" number provided for line subscribers to call with questions about their bills. That number was widely used. During the Sprint period, 91,683 bills were sent to line subscribers and at least 24,986 subscribers contacted Verity about the bills. Calling the customer-service center was not a positive experience for many invoice recipients. The center was so understaffed that 72% of the calls placed to it were abandoned by callers. While waiting on hold for a customer-service representative, callers were played a recording warning that "[f]ailure to pay a Verity International bill may result in the blocking of your phone line to services of this nature from a variety of content prov. lers and further collection activity of past due amounts." Once connected to a customer-service representative, callers had to weather a "hard sustain" approach that involved the representative advising callers that the charges were valid, that the charges must be paid, and that nonpayment would subject the line subscriber to further collection activity. Robert Green and Marilyn Shein instructed the call center to maintain this hard-sustain approach, which did not change until the FTC brought the present lawsuit. During the Sprint Period, the Verity bills resulted in $1.6 million in collected billings and over 500 consumer complaints to the FTC. The billing system has not been resurrected after Sprint stopped carrying its calls.

III. Procedural History

A. The FTC's complaint

The FTC's complaint alleged that certain aspects of the defendants-appellants' billing system were deceptive or unfair trade practices in violation of § 5(a)(1) of the FTC Act. That section provides that "unfair or deceptive acts or practices in or *55 affecting commerce . . . are hereby declared unlawful." 15 U.S.C. § 45(a)(1). The FTC's second amended complaint claimed relief on three grounds relevant on appeal. In Count I, the FTC alleged that the defendants-appellants engaged in a deceptive practice by falsely representing that a consumer could not legally avoid charges for website content accessed over the consumer's telephone line, even if the consumer did not access the content or authorize others to do so. In Count II, the FTC alleged that the defendants-appellants engaged in an unfair practice by themselves or through others "billing and attempting to collect from line subscribers" whose telephone lines were used to access online adult content but who did not access or authorize others to access that content. In Count III, the FTC alleged that it was a deceptive practice for the defendants-appellants to cause billing statements to misrepresent the destination of outbound calls as Madagascar when in fact the calls did not terminate there.

B. Parties

ACL is a Bahamian corporation that operated the billing system in dispute. It was founded and controlled by Robert Green and Marilyn Shein, each of whom owned 40% of ACL's shares until September 20, 2000, when an Australian corporation, Oriel Communications, Ltd., acquired half of ACL's shares. The acquisition left Green and Shein each holding 20% of ACL's shares and approximately 11% of Oriel's shares. Green and Shein also founded and controlled

Verity, a short-lived operation that was part of the billing system and was used for accounting purposes.

C. Preliminary injunction and contempt

On December 13, 2000, the district court entered a preliminary injunction that imposed an asset freeze on Verity, Green, and Shein to preserve funds for a possible monetary remedy. The preliminary injunction also required each of them to complete and return to the FTC a financial-disclosure form. The FTC proposed the financial-disclosure requirement as a way to evaluate the reasonableness of Green's and Shein's requests to unfreeze assets for living expenses, so Green and Shein did not contest the requirement at the time. Green and Shein contend that upon seeing the enormous amount of information requested by the disclosure form, they decided not to seek a release of their frozen assets and not to complete the disclosure form. But the court's order to do so stood. Accordingly, the district court ordered Green and Shein held in contempt of court for their failure to comply with the preliminary injunction's financial-disclosure requirement, an order from which Green and Shein appeal. The district court imposed a coercive per-day fine for their noncompliance and ordered their civil confinement, should they be found within the United States, until they complied with the financial-disclosure requirement. Soon thereafter, the district court denied their motion to lift the financial-disclosure requirement and held that disclosure was necessary "to assure enforcement of an asset freeze or to recover proceeds of wrongdoing that are the subject of an equitable claim for disgorgement." To date, neither Green nor Shein has completed the financial-disclosure form. As of October 7, 2005, the date on which this appeal was argued, the coercive monetary fines totaled $16.1 million per contemnor.

D. Motion practice and bench trial

The defendants-appellants filed a motion for judgment on the pleadings, contending that the district court lacked subject-matter jurisdiction because (1) ACL was a *56 common carrier outside of the FTC's jurisdiction, (2) the filed-rate doctrine negated standing by precluding the FTC from contending that line subscribers could avoid the charges in question, and (3) the primary-jurisdiction doctrine required the FCC to first decide the case. The district court asked the FCC to brief, as amicus curiae, the merits of the defendants-appellants' contentions, and the United States Attorney for the Southern District of New York submitted a letter brief on behalf of the FCC answering the district court's questions. He concluded that ACL was not a common carrier under the Communications Act and that the primary-jurisdiction and filed-rate doctrines therefore did not apply. With the benefit of the FCC's views, the district court denied the defendants-appellants' motion for judgment on the pleadings and found that it had subject-matter jurisdiction to hear the case.

On September 17, 2004, following a bench trial on a record of stipulated facts, declarations, exhibits, and other evidence, the district court filed a memorandum opinion. The court incorporated the factual findings and legal holdings of its earlier opinion denying defendants-appellants' motion for judgment on the pleadings, held that the FTC proved Counts I, II, and III of its second amended complaint, and held that individual as well as corporate liability was appropriate. Finding the restitutionary remedy of disgorgement to be available and proper, the district court entered two money judgments against the defendants-appellants for a total of $17.9 million. The court also replaced the preliminary injunction with a permanent injunction, which did not contain a financial-disclosure requirement. The defendants-appellants timely appealed from the district court's judgment.

DISCUSSION

Our review proceeds in multiple parts. In Parts I-III, we consider and find meritless the defendants-appellants' arguments that the district court lacked subject-matter jurisdiction. Next, in Part IV, we consider a challenge to the district court's determination that the trade practices at issue violated § 5(a)(1) of the FTC Act and uphold the district court. Part V discusses why the district court erred in awarding monetary relief of $17.9 million. Finally, Part VI turns to the coercive contempt sanctions against Green and Shein, explaining why we must vacate them as moot.

I. The Common-Carrier Exception to the FTC's Enforcement Power

The FTC Act limits the FTC's enforcement power. Pertinent here is the FTC's inability to enforce § 5(a)(1) of the FTC Act against "common carriers subject to the Acts to regulate commerce." 15 U.S.C. § 45(a)(2) (providing this "common-carrier exception" to the FTC's powers). One such act "to regulate commerce" is the Communications Act of 1934, along with its amendatory acts. *Id.* § 44 (citing the Communications Act of 1934, 47 U.S.C. § 151 *et seq.*). ACL argues that it is a telecommunications common carrier under the Communications Act and that therefore the common-carrier exception renders § 5(a)(1) of the FTC Act inapplicable.[1]

[1] This contention raises the question whether the term "common carrier" under the FTC Act has the same meaning as the term "common carrier" under the Communications *57 Act. As explained below, we determine that "common carrier" under the FTC Act is properly defined by reference to the common law of carriers and not to the Communications Act, even

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[1] Defendants-appellants Verity, Green, and Shein do not claim the benefit of this exception to the FTC Act.

though the common law definition does not meaningfully differ from the Communications Act definition for the purposes of this appeal. Under both definitions, ACL is not a common carrier. A brief history of the two acts is helpful in explaining our conclusion.

The first federal regulation to impose duties on common carriers was the Interstate Commerce Act of 1887 ("ICA"), ch. 104, 24 Stat. 379 (1887), which applied to "any common carrier or carriers" engaged in the railroad transportation of people or property interstate. The ICA imposed on railroad common carriers traditional common-carrier requirements such as nondiscrimination, tariff-filing, and charging just and reasonable rates, *id.* § § 1-7, and it created the Interstate Commerce Commission ("ICC") to administer the provisions of the act, *id.* § § 11-12. In 1910, Congress passed the Mann-Elkins Act, ch. 309, 36 Stat. 539 (1910), which amended the ICA to apply to interstate telephone companies and to deem such companies common carriers, *id.* § 7(1). Neither the ICA nor the Mann-Elkins Act contained a definition of "common carrier."

In 1914, in the thick of the antitrust movement, Congress passed the Federal Trade Commission Act (the "FTC Act"), ch. 311, 38 Stat. 717 (1914), which created the Federal Trade Commission ("FTC") as an enforcement agency. Congress did not intend the FTC to enforce unfair-competition law[2] against common carriers because the ICC already regulated common carriers under the Interstate Commerce Act. Thus, for the purpose of preventing interagency conflict, the FTC Act common-carrier exception was created. *See generally* Marc

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[2] Section 5(a)(1) of the FTC Act originally prohibited only "[u]nfair methods of competition in or affecting commerce." The Wheeler-Lea Act of 1938 expanded § 5(a)(1) to also prohibit "unfair or deceptive acts or practices in or affecting commerce." § 3, 52 Stat. 111, 111 (1938).

Winerman, *The Origins of the FTC,* 71 Antitrust L.J. 1, 69 n.413 (2003) (mentioning the genesis of the common-carrier exception). Just as Congress had not provided a definition of "common carrier" in the Interstate Commerce Act, it did not provide a definition for that term in the FTC Act.

Regulation of telephone common carriers continued to rest with the ICC until 1934, when Congress passed the Communications Act of 1934, ch. 652, 48 Stat. 1064 (1934).[3] That act created the Federal Communications Commission ("FCC") and transferred to the FCC regulatory authority over telephone common carriers. *Id.* The Communications Act defined "common carrier" circularly, as "any person engaged as a common carrier for hire, in interstate or foreign communications by wire or radio . . . ." 47 U.S.C. § 153(10). As one researcher has noted, the conference report for the Communications Act of 1934 suggests that the phrase "common carrier" had an ordinary meaning at the time, explaining why the Interstate Commerce Act left the term undefined and why the Communications Act included only a circular definition. Phil Nichols, *Redefining "Common Carrier,"* 1987 Duke L.J. 501, 511. Congress did not modify the exemption of common carriers from FTC regulatory authority except to extend the exemption *58 to common carriers now subject to the Communications Act. Wheeler-Lea Act of 1938, § 2, 52 Stat. 111, 111 (1938).

The foregoing description brings us to the state of the relevant law today, against which we assess ACL's assertion that the correct definition for "common carrier" under the FTC

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[3] *See generally* James B. Speta, *A Common Carrier Approach to Internet Interconnection,* 54 Fed. Comm. L.J. 225, 263 (2002) ("[T]he Act responded to the facts that most states had established commissions governing local telephone service and that the ICC felt overburdened by its regulation of railroads.").

Act is found in the Communications Act. We find no statutory basis for so concluding. The term "common carrier" in § 5(a)(2) of the FTC Act is still undefined, both in the act itself and in FTC regulations. As did our sister circuit when interpreting the circular definition of "common carrier" under the Communications Act, we decide to give meaning to "common carrier" in the FTC Act according to the ordinary sense of the word when Congress used it to create the exemption. *See Nat'l Ass'n of Regulatory Util. Comm'rs v. FCC ("NARUC II"),* 533 F.2d 601, 608-09 (D.C.Cir.1976) (turning to the common law to define "common carrier" under the Communications Act); *Nat'l Ass'n of Regulatory Util. Com'rs v. FCC ("NARUC I"),* 525 F.2d 630, 640-42 (D.C.Cir.1976) (taking the same approach); *cf. Sec. Indus. Ass'n v. Bd. of Governors of the Fed. Reserve Sys.,* 468 U.S. 137, 149-50, 104 S.Ct. 2979, 82 L.Ed.2d 107 (1984) (interpreting the undefined terms "security" and "note" by reference to their ordinary meaning to the 1933 Congress that used them).

The concept of a common carrier dates from the English common law and can be traced back to at least 1670 and the writings of Lord Chief Justice Hale. *See Munn v. Illinois,* 94 U.S. 113, 126, 4 Otto 113, 24 L.Ed. 77 (1876) (referencing Lord Hale's treatise). Early common-carrier law applied to "almost all workers and tradesmen," requiring them to "serve the public generally and to do so on just and reasonable terms," but over time, the common law of common carriers narrowed its focus to enterprises considered "public" in some way, such as by the government grant of a legal monopoly or their use of public funds. James B. Speta,*A Common Carrier Approach to Internet Interconnection,* 54 Fed. Comm. L.J. 225, 255-57 (2002); *see also* Nichols, *supra,* at 506-07 (describing Lord Hale's concept of public interest in privately held business).

Eventually, the definition of a common carrier coalesced into two requirements: (1) the entity holds itself out as undertaking to carry for all people indifferently; and (2) the entity carries its cargo without modification. *See NARUC I,* 525 F.2d at 64042 (describing how the common law imposed common-carrier regulation on entities that undertook to carry for all shippers or travelers indifferently); *NARUC II,* 533 F.2d at 608-09 (describing the "without modification" requirement); Nichols, *supra,* at 508-09 (quoting the formulation of an 1857 carriers treatise that "[t]o render a person liable as a common carrier, he must exercise the business of carrying as a 'public employment,' and must undertake to carry goods for all persons indiscriminately"). This definition does not differ meaningfully for our purposes from the definition of "common carrier" under the Communications Act– both require that an entity provides carriage to the public. *See* 47 U.S.C. § 153(43), (44), (46) (providing that "[t]he term 'telecommunications carrier' means any provider" offering to the public "the transmission . . . of information").

[2] Applying these definitions, we conclude that defendant-appellant ACL is not a common carrier subject to the Communications Act and therefore does not fit within the FTC Act common-carrier exemption. The carriage of the telephone calls in this case involved three carriers in concept and two carriers in fact. Conceptually, the calls were carried by an originating *59 carrier, a transit carrier, and a destination carrier. AT&T, and later Sprint, served as the originating carrier, routing the calls from the United States to the United Kingdom. The transit carrier was AT&T U.K./Viatel, whose role as transit carrier was, in concept, "to route traffic [from an originating carrier] to a carrier in another country, the destination carrier." *In re AT&T Corp.,* 14 F.C.C.R. 19140, 19176 n. 168, 1999 WL 979615 (1999). Conceptually, Telecom Malagasy was the destination carrier, with ACL standing in its

shoes by virtue of the agreement assigning ACL the right to terminate calls placed to Telecom Malagasy's numbers. Even at this conceptual level, ACL is not exempt from the FTC Act because foreign terminating carriers are not carriers subject to the Communications Act, as contemplated by the FTC Act's common-carrier exemption. 15 U.S.C. § § 44, 45(a). An entity is subject to the Communications Act if it is "engaged within the United States" in "interstate and foreign communication by wire or radio [or] . . . interstate and foreign transmission of energy by radio, which originates and/or is received within the United States." 47 U.S.C. § 152(a). As indicated by the "engaged within the United States" limitation, the Communications Act does not apply to foreign terminating carriers. *Cable & Wireless P.L.C. v. FCC,* 166 F.3d 1224, 1229-30 (D.C.Cir.1999) (finding that because an FCC order applied to only domestic carriers, not foreign carriers, the FCC did not exceed its authority under the Communications Act in issuing it; noting that the FCC "claims no authority to directly regulate foreign carriers"). Thus, as a purely foreign terminating carrier at the conceptual level, ACL would not qualify for the FTC Act exemption.

Yet our determination that ACL was not a common carrier is even simpler because, in fact, the telephone calls at issue were carried by only two entities–the originating carrier and the transit carrier. AT&T, and later Sprint, carried the phone calls from the United States to the United Kingdom as originating carrier, and AT&T U.K./Viatel carried the phone calls to the U.K. internet servers where they were terminated. ACL simply brought together these carriers as part of its billing system; it never itself carried any calls. Thus, while AT&T and Sprint might be exempt from FTC enforcement, ACL is not.

On appeal, ACL presses the argument that the § 5(a)(2) common-carrier exemption applies to an entity with the "status

of a common carrier" under the Communications Act,[4] even if its activities relevant to a pending lawsuit are not common carriage. Assuming *arguendo* that common carrier "status" can exist and is determinative, this argument would aid ACL only if it had the status of a common carrier. ACL contends that it holds such status because the FCC granted it a license pursuant to 47 U.S.C. § 214 (the " § 214 license"), yet this license simply authorizes ACL "to *become* a facilities-based international common carrier . . . and/or to *become* *60 a resale-based international common carrier" (emphasis added). The § 214 license does not purport to represent or determine that ACL is actually engaged in common carriage, nor did ACL's application for the license so represent. Rather than rely on what an entity is authorized to do, courts must examine the actual conduct of an entity to determine if it is a common carrier for purposes of the FTC Act exemption. *Cf. Eagleview Techs., Inc. v. MDS Assocs.*, 190 F.3d 1195, 1197-98 (11th Cir.1999) (holding that an entity's possession of an FCC license to provide services as a common carrier did not alone make the entity a common carrier under the Communications Act). Here, as explained above, none of ACL's activities gave it the status of a common carrier subject to the Communications Act of

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[4] The notion of some indelible common carrier "status" under the Communications Act is highly questionable. *See Southwestern Bell Tel. Co. v. FCC*, 19 F.3d 1475, 1481 (D.C.Cir.1994) (explaining that "[w]hether an entity in a given case is to be considered a common carrier or a private carrier turns on the particular practice under surveillance" and that the FCC "is not at liberty to subject [an] entity to regulation as a common carrier" if the entity "is acting as a private carrier for a particular service"); *see also NARUC II*, 533 F.2d at 608 ("[I]t is at least logical to conclude that one can be a common carrier with regard to some activities but not others."); *In re Audio Commc'ns, Inc.*, 1993 WL 525815, 8 F.C.C.R. 8697, 8698-99, ¶ 12 (1993) ("[A] single firm that is a common carrier in some roles need not be a common carrier in other roles.").

1934, and accordingly, the FTC Act common-carrier exception would not apply.

II. The Primary-Jurisdiction Doctrine

[3][4] The doctrine of primary jurisdiction allows a federal court to refer issues "extending beyond the 'conventional expertise of judges' or 'falling within the realm of administrative discretion' "to the appropriate administrative agency for resolution in the first instance. *Nat'l Commc'ns Ass'n, Inc. v. AT&T Co.*, 46 F.3d 220, 222-23 (2d Cir.1995) (quoting *Far East Conference v. United States,* 342 U.S. 570, 574, 72 S.Ct. 492, 96 L.Ed. 576 (1952))." Specifically, courts apply primary jurisdiction to cases involving technical and intricate questions of fact and policy that Congress has assigned to a specific agency." *Id.* at 223. Although there is "[n]o fixed formula . . . for determining whether an agency has primary jurisdiction," courts typically consider four factors in this analysis:

> (1) whether the question at issue is within the conventional experience of judges or whether it involves technical or policy considerations within the agency's particular field of expertise;
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> (2) whether the question at issue is particularly within the agency's discretion;
>
> (3) whether there exists a substantial danger of inconsistent rulings; and
>
> (4) whether a prior application to the agency has been made.

Id. at 222, 223.

The defendants-appellants contend that the district court should have referred this case to the FCC because it raises complex questions of telecommunications policy. Of the

questions raised in this case, the only issue that deserves close primary-jurisdiction analysis pertains to the interpretation of Communications Act terms. That issue, important to our discussion in Part III of the filed-rate doctrine, is whether the services offered by ACL are telecommunications services or, alternatively, information services.

[5] The four primary-jurisdiction factors do not favor finding FCC primary jurisdiction over the characterization of the services provided by ACL. First, there are many precedents, including those of the FCC, on the meaning of the Communications Act terms "information service" and "telecommunications service." *See, e.g., Nat'l Cable & Telecommc'ns Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 125 S.Ct. 2688, 2702-10, 162 L.Ed.2d 820 (2005); *In re Federal-State Joint Bd. on Universal Serv.* ("*Universal Service Report*"), 13 F.C.C.R. 11501, 11531, 1998 WL 166178 (1998); *see generally* Peter W. Huber et al., *Federal Telecommunications Law* § 12.2, at 1077-86 (1999). The job of applying these reasonably settled definitions to the facts of this case is within the court's competence. *See Nat'l Commc'ns Ass'n*, 46 F.3d at 223 ("This record does *61 not present any issues involving intricate interpretations . . . that might need the FCC's technical or policy expertise."). Second, while the classification issue is within the FCC's discretion in the sense that the FCC is charged with administering the Communications Act, nothing about the terms invokes the FCC's discretion in the same way that more abstract statutory terms such as "reasonable" or "public interest" do. *See id.* ("This case, however, does not involve the statutory reasonableness of the tariff or other abstract concepts. Instead, it focuses on . . . a rather simple factual question . . . ."). Third, the defendants-appellants have pointed to no danger of inconsistent rulings on the classification of their service. Fourth, to the extent that the defendants-appellants contend that

LO/AD Communications, B.V.I., Ltd. v. MCI WorldCom, No. 00 Civ. 3594, 2001 WL 64741 (S.D.N.Y. Jan.24, 2001), was a prior application to the FCC on the classification issue, they are incorrect. That case concerned the abstract "reasonableness" standard of 47 U.S.C. § 201, not application of the descriptors that this case asks the court to apply. *Id.* at *2-*3. In sum, none of the four primary-jurisdiction factors weigh in favor of referring the case to the FCC on this issue.

The remaining issues in this case go to deceptiveness, unfairness, and common-carrier status under the FTC Act. Congress did not place the interpretation of these terms within the realm of FCC discretion, nor does the FCC have special expertise in interpreting these FTC Act terms. Although the defendants-appellants contend that "[e]very other court presented with these issues has referred them to the FCC," in each of the cited cases, the claimed violation was of the Communications Act, not the FTC Act. *GTE.Net LLC v. Cox Commc'ns, Inc.,* 185 F.Supp.2d 1141, 1144 (S.D.Cal.2002); *Audiotext Int'l, Ltd. v. MCI WorldCom Commc'ns, Inc.,* No. Civ. A. 00-3982, 2001 WL 1580316, at * 2-*3 (E.D.Pa. Dec.11, 2001); *LO/AD Commc'ns,* 2001 WL 64741, at *1. We note that the FCC filed an amicus submission stating that it had no particular interest in or expertise over the case so as to warrant declining jurisdiction. For the reasons given above, we conclude that the primary-jurisdiction doctrine does not require referring this case to the FCC.

III. The Filed-Rate Doctrine

[6] The defendants-appellants also contend that the filed-rate doctrine, also known as the filed-tariff doctrine, deprives the FTC of standing and requires dismissal of its complaint. That doctrine is grounded statutorily in the Communications Act's requirement that all common carriers file a schedule of their rates, i.e., a tariff, for FCC approval. 47 U.S.C. § 203(a).

Once the FCC approves the tariff, the rates filed for the carrier's services are the only lawful charge. *Id.* § 203(c); *AT&T Co. v. Cent. Office Tel., Inc.*, 524 U.S. 214, 222, 118 S.Ct. 1956, 141 L.Ed.2d 222 (1998). Under the filed-rate doctrine, customers of the carrier "are charged with notice of [the tariff], and they as well as the carrier must abide by it, unless it is found by the [FCC] to be unreasonable." *Cent. Office Tel.*, 524 U.S. at 222, 118 S.Ct. 1956 (quoting *Louisville & Nashville Ry. Co. v. Maxwell*, 237 U.S. 94, 97, 35 S.Ct. 494, 59 L.Ed. 853 (1915)). The doctrine serves the dual purposes of preventing carrier price discrimination and reserving the rate-making role to federal agencies by keeping courts from adjudicating the validity or reasonableness of carrier charges. *Marcus v. AT&T Corp.*, 138 F.3d 46, 58 (2d Cir.1998). It is applied strictly to prevent a plaintiff from bringing a challenge to the validity of a filed tariff, "even in the face of apparent inequities." *Id.* at 59.

*62 [7] The defendants-appellants contend that the filed-rate doctrine bars the present action. They reason that because the FCC approved AT&T's and Sprint's tariffs for the carriage of calls placed to Madagascar and because the bills sent to line subscribers charged only tariffed rates, any lawsuit founded on the premise that some subscribers were not required to pay for calls placed over their lines is attacking the validity of FCC-approved tariffed rates and is therefore barred by the filed-rate doctrine. Underlying this assertion, however, is the foundational assumption that the bills in dispute were for services covered by the FCC-approved tariffs. If, in fact, no filed tariff covered the service for which the defendants-appellants sought to charge line subscribers, there would be no filed rate to charge subscribers with notice of and no tariff's validity would be called into question by the FTC's lawsuit.

We hold that the filed-rate doctrine does not apply in this case because the defendants-appellants point to no tariff that

covers the actual service rendered to users of their billing system. The defendants-appellants contend that the tariffs filed by AT&T and Sprint apply, but those tariffs cover only telecommunications services, not the information services provided here. The Communications Act defines these two categories of service. A "telecommunications service" (for example, the carriage of a basic voice telephone call) is the offering of "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43), (46). An "information service," on the other hand, offers "a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications." *Id.* § 153(20). Examples include services allowing online browsing or electronic publishing *Id.*; *see generally Universal Service Report,* 13 F.C.C.R. 11501, 1998 WL 166178 (1998) (discussing in depth the meaning of these statutory terms). The FCC has affirmed that the two types of service are mutually exclusive. *Universal Service Report,* 13 F.C.C.R. at 11507-08, ¶ 13. The FCC has further explained that "mixed or hybrid services," in which the provider "offers a capability for generating, acquiring, . . . or making available information via telecommunications, and as an inseparable part of that service transmits information supplied or requested by the user," are information services and not telecommunications services. *Id.* at 11529, ¶¶ 56-57.

In applying these definitions, the defendants-appellants would have us focus on only part of their billing system. They contend, and it is certainly true, that the carriers handling transmission of computer users' phone calls–AT&T, Sprint, and AT&T U.K./Viatel–did not change the form or content of the information transmitted. But examining only the service provided by these carriers misses the fundamental question in

the filed-rate-doctrine analysis: the nature of the service for which consumers were billed. In this case, while the pure transmission of information–provided by AT&T, Sprint, and AT&T U.K./Viatel–was part of the service rendered to computer users, those users received more as part of their purchase, namely, adult content. It can hardly be denied that access to adult websites motivated computer users to run the GIB dialer program and incur charges via the defendants-appellants' billing system. Indeed, the funds collected from paying line subscribers compensated both telecommunications carriers and adult-website operators. As explained above, and as undisputed by the parties, online adult entertainment is an information service and *63 is therefore not covered by the AT&T or Sprint tariffs upon which the defendants-appellants rely. Because the defendants-appellants point to no other tariff covering the information service rendered to users of their billing system, the filed-rate doctrine does not apply. Accordingly, the FTC has standing to bring this action.

IV. Violation of the FTC Act

Section 5(a)(1) of the FTC Act declares unlawful "[u]nfair or deceptive acts or practices in or affecting commerce." 15 U.S.C. § 45(a)(1). Following a bench trial, the district court ruled that the FTC had proved three bases for relief under § 5(a)(1), and the court entered judgment against the defendants-appellants accordingly. On appeal, the defendants-appellants contend that the district court erred because the FTC did not prove each of the elements required for relief. We review the district court's conclusions of law de novo and its factual findings for clear error. *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 238 (2d Cir.2003).

A. Count I

[8][[9][10] In Count I, the FTC alleged that the defendants-appellants engaged in a deceptive act or practice by

falsely representing that a consumer could not successfully avoid charges for adult-website content accessed over the consumer's telephone line, even if the consumer did not access the content or authorize others to do so. To prove a deceptive act or practice under § 5(a)(1), the FTC must show three elements: "[1] a representation, omission, or practice, that [2] is likely to mislead consumers acting reasonably under the circumstances, and [3], the representation, omission, or practice is material." *In re Cliffdale Assocs., Inc.*, 103 F.T.C. 110, 165 (1984); *accord FTC v. Tashman,* 318 F.3d 1273, 1277 (11th Cir.2003); *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1029 (7th Cir.1988). The deception need not be made with intent to deceive; it is enough that the representations or practices were likely to mislead consumers acting reasonably. *World Travel,* 861 F.2d at 1029.

The FTC contends that the first element is satisfied by proof that the defendants-appellants caused telephone-line subscribers to receive explicit and implicit representations that they could not successfully avoid paying charges for adult entertainment that had been accessed over their phone lines–what we call a "representation of uncontestability." The district court found that during the AT&T period, the defendants-appellants caused charges for adult entertainment to appear on AT&T phone bills as telephone calls, thereby "capitaliz[ing] on the common and well-founded perception held by consumers that they must pay their telephone bills, irrespective of whether they made or authorized the calls." The district court found that this representation was also made during the Sprint Period by the format of the Verity bills and the call-center messages delivered to bill recipients. Upon reviewing the bills and call-center practices, we find that it was not clearly erroneous for the district court to find that they conveyed a representation of uncontestability. *See, e.g., Kemp v. AT&T Co.*, 393 F.3d 1354, 1360 (11th Cir.2004) ("It was

clearly foreseeable that this [phone-bill] formatting [, which listed information-service purchases as long-distance-telephone-call charges,] would cause some customers to think that . . . the charges had to be paid in order to maintain phone service.").

The second requirement for § 5(a)(1) liability is that the defendants-appellants' representation be likely to mislead consumers acting reasonably. The FTC contends *64 that the representation of uncontestabilty was false and therefore likely to mislead consumers who did not use or authorize others to use the adult entertainment in question; the defendants-appellants contend that the representation was rendered true by both the filed-rate doctrine and common law agency principles. We have already explained why the filed-rate doctrine does not apply, *see supra* Part III, so we turn now to the defendants-appellants' agency argument.

[11][12] Under common law agency principles, a person is liable to pay for services that she does not herself contract for if another person has actual, apparent, or implied authority to consent on her behalf to pay for the services. *Merrill Lynch Interfunding, Inc. v. Argenti,* 155 F.3d 113, 122 (2d Cir.1998); Restatement (Second) of Agency § 140 (1958). The defendants-appellants rely on apparent authority, contending that all calls made over a subscriber's telephone line were necessarily made with the subscriber's apparent authority because any user of a computer connected to that telephone line must have been given authority by the line subscriber to use the computer.

Apparent authority, "[u]nlike express or implied authority, . . . exists entirely apart from the principal's manifestations of consent to the agent." *Towers World Airways, Inc. v. PHH Aviation Sys., Inc.,* 933 F.2d 174, 177 (2d Cir.1991). Rather, it would derive here either from manifestations of the principal

(the line subscriber) to a third party (an entity involved in the billing system) or from the putative agent's (the computer user's) position, when justified by ordinary expectations and habits. Restatement (Second) of Agency § 49 cmts. a, b (1958). The defendants-appellants analogize the present case to *Towers World Airways, supra,* in which we held that purchases by a company's employee made with a properly issued company credit card are made with the apparent authority of the company. 933 F.2d at 177-79. Notably, that case concerned a principal's entrustment of a payment mechanism to its agent and relied upon specific customs of the aviation industry in finding apparent authority. *Id.* at 178. Here, in contrast, the computer is a multipurpose tool that is not primarily understood as a payment mechanism, and in the ordinary habits of human behavior, one does not reasonably infer that because a person is authorized to use a computer, the subscriber to the telephone line connected to that computer has authorized the computer user to purchase online content on the subscriber's account. Apparent authority does not exist on these facts.

The representation of uncontestability is therefore false, unsupported by either the filed-rate doctrine or common law agency principles. Because the defendants-appellants offer no reason why this misrepresentation would not be likely to mislead consumers acting reasonably, we find that the district court did not err in finding that the FTC proved the second element of its Count I claim.

Finally, to establish a deceptive act or practice under § 5(a)(1), the FTC must prove that the misrepresentation was material to consumers. The district judge never expressly addressed whether the representation of uncontestability was material, but because he stated the correct legal standard for § 5(a)(1) deceptiveness liability and found liability upon labeling the representation "materially false," we understand him to

mean that the misrepresentation was material and false–a slightly different, but justifiable, conclusion. The FTC submitted evidence from which the district court could conclude that telephone-line subscribers found the representation material to their decision whether *65 to pay the billed charges because of the worry of telephone-line disconnection, the perception of the futility of challenging the charges, the desire to avoid credit-score injury, or some combination of these factors. In any event, nowhere in the defendants-appellants' briefing do they contend that the misrepresentation of uncontestability was immaterial, so we deem the issue waived. *Norton v. Sam's Club,* 145 F.3d 114, 117 (2d Cir.1998).

In sum, because the FTC proved all three elements of its § 5(a)(1) claim premised on the deceptive representation of uncontestability, the district court did not err in holding that the defendants-appellants violated the FTC Act. Because § 5(a)(1) is phrased in the disjunctive, prohibiting "unfair *or* deceptive" acts or practices, 15 U.S.C. § 45(a)(1), the FTC need not prove its other claims to obtain relief under the FTC Act. Liability is supported by the Count I claim alone. Nonetheless, we give brief attention below to Count II because it affects the scope of injunctive relief.

B. Count II

[13] The district court held the defendants-appellants liable under Count II of the FTC's complaint, which alleged that "billing line subscribers who did not use or authorize use of the Internet services offered by the defendants' clients" was an unfair trade practice. We hold that the defendants-appellants waived their right to contest this unfair-practices determination by not raising it as an issue on appeal. The defendants-appellants presented several issues for review in their opening brief, and in the paragraph concerning FTC Act liability, they

mention only the district court's deceptiveness determination; indeed, in the four pages of their opening brief in which they discuss FTC Act liability, they focus only on deceptive-practice liability. Because the defendants-appellants did not contest the district court's unfair-practices determination until their reply brief, and then only cursorily, we deem it waived on appeal. *Tischmann v. ITT/Sheraton Corp.*, 145 F.3d 561, 568 n. 4 (2d Cir.1998) (holding an argument waived because the appellant did not raise it until his reply brief); *United States v. Gabriel*, 125 F.3d 89, 100 n. 6 (2d Cir.1997) (same). For this reason, we affirm the district court's determination that the act of "billing line subscribers who did not use or authorize use of the internet services offered by the defendants' clients" is an unfair trade practice within the meaning of § 5(a)(1). Because the FTC prevails on the basis of waiver, we do not reach, and therefore express no opinion on, the district court's rulings on the merits of the Count II claim.

C. Count III

In Count III, the FTC alleged that it was a deceptive practice for the defendants-appellants to cause consumers to be billed for calls to Madagascar when the calls actually terminated in the United Kingdom. Because liability under this count is not necessary to support the district court's order of relief, we express no opinion on the district court's determination that the FTC proved this claim for relief.

* * * * * *

We affirm the injunctive components of the district court's October 26, 2004 final order for relief because they are supported by the defendants-appellants' liability under Counts I and II of the FTC's complaint.

V. Restitution

Two issues determine whether the district court's award of disgorgement relief to the FTC should be affirmed. First, is *66 restitution an available remedy under § 13(b) of the FTC Act, the provision under which the FTC seeks relief? Second, if so, did the district court correctly administer the restitution remedy?

A. Restitution under § 13(b) of the FTC Act

[14] The FTC brought this action under the second proviso of § 13(b) of the FTC Act, which states that "in proper cases the [FTC] may seek, and after proper proof, the court may issue, a permanent injunction." 15 U.S.C. § 53(b). Although this provision does not expressly provide for restitution, several

courts, including the Fifth,[5] Seventh,[6] Eighth,[7] Ninth,[8] and Eleventh[9] Circuits, have concluded that § 13(b) of the FTC Act allows restitution or other ancillary equitable relief. *Cf. United*

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[5] *FTC v. Southwest Sunsites, Inc.*, 665 F.2d 711, 718 (5th Cir.1982) (concluding that "a grant of jurisdiction such as that contained in Section 13(b) carries with it the authorization for the district court to exercise the full range of equitable remedies traditionally available to it" and holding that § 13(b) "contains no express limitations on the otherwise full powers of the district court to mold appropriate decrees under its traditional equitable jurisdiction").

[6] *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1026 (7th Cir.1988) (holding that the district court had power to grant a preliminary injunction under § 13(b) because Congress did not limit the court's inherent equitable powers).

[7] *FTC v. Sec. Rare Coin & Bullion Corp.*, 931 F.2d 1312, 1314 (8th Cir.1991) (upholding the district court's rescission remedy despite § 13(b)'s failure to expressly allow that remedy because "[w]here Congress allows resort to equity for the enforcement of a statute, all the inherent equitable powers of the district court are available for the proper and complete exercise of the court's equitable jurisdiction, unless the statute explicitly, or by a necessary and inescapable inference, limits the scope of that jurisdiction") (citing *Porter v. Warner Holding Co.*, 328 U.S. 395, 397-98, 66 S.Ct. 1086, 90 L.Ed. 1332 (1946)).

[8] *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1113 (9th Cir.1982) (reasoning that the district court has authority to grant an asset freeze and rescission in a case brought under § 13(b) of the FTC Act because "[u]nless otherwise provided by statute, all the inherent equitable powers of the [d]istrict [c]ourt are available for the proper and complete exercise of that jurisdiction").

[9] *FTC v. Gem Merch. Corp.*, 87 F.3d 466, 469-70 (11th Cir.1996) (holding that the district court could award consumer redress for violations of the FTC Act because § 13(b) invoked the court's equitable jurisdiction and "absent a clear command to the contrary, the district court's equitable powers are extensive" and include "the power to grant restitution and disgorgement").

States v. Lane Labs-USA, Inc., 427 F.3d 219, 223 (3d Cir.2005) (holding that even though a statute did not expressly allow courts to award restitution, "such specificity is not required where the government properly invokes a court's equitable jurisdiction").

The defendants-appellants do not contest on appeal the district court's holding that restitution is available as ancillary equitable relief under § 13(b) of the FTC Act, so we assume without deciding that the district court's holding is correct. *See, e.g., United States v. Georgia*, —U.S. —, 126 S.Ct. 877, 880, 163 L.Ed.2d 650 (2006) (applying this type of assumption).

The defendants-appellants do argue, however, that such restitution must be limited to so-called equitable restitution. We agree. This contention is based on the fact that two types of restitution are distinguishable: As Justice Scalia explained in *Great-West Life & Annuity Insurance Co. v. Knudson*, 534 U.S. 204, 122 S.Ct. 708, 151 L.Ed.2d 635 (2002), "In the days of the divided bench, restitution was available in certain cases at law, and in certain others in equity." *Id.* at 212, 122 S.Ct. 708. Equitable*67 restitution allowed the plaintiff to recover money or property in the defendant's possession that could "clearly be traced" to money or property "identified as belonging in good conscience to the plaintiff." *Id.* Legal restitution, on the other hand, was awarded when the plaintiff could not assert title to or the right to possession of particular property but nevertheless had some basis for recovering for some benefit that the defendant wrongly received from the plaintiff. *Id.* Here, because the availability of restitution under § 13(b) of the FTC Act, to the extent it exists, derives from the district court's equitable jurisdiction, it follows that the district

court may award only equitable restitution.[10] The fact that only an equitable remedy is available eviscerates the defendants-appellants' contention that the Seventh Amendment confers a right to a jury trial in this case. *See Granfinanciera, S.A. v. Nordberg,* 492 U.S. 33, 41, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989).

B. Administering restitutionary relief

[15] The district court strayed off course in its application of the two-step burden-shifting framework for calculating the size of disgorgement relief. This framework requires the FTC to first "show that its calculations reasonably approximated" the amount of the defendant's unjust gains, after which "the burden shifts to the defendants to show that those figures were inaccurate." *FTC v. Febre,* 128 F.3d 530, 535 (7th Cir.1997) (citing *SEC v. Lorin,* 76 F.3d 458, 462 (2d Cir.1996) (per curiam)). Two errors pervade the district court's administration of this framework: (1) misidentifying the baseline for restitutionary relief and (2) prematurely shifting the burden of proof to the defendants-appellants.

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[10] We emphasize that equitable restitution is not limited to an award of the very funds that unjustly enriched the defendant and are still in the defendant's possession. Rather, tracing principles apply to allow a plaintiff to follow unjustly obtained funds into their product in the defendant's possession. *See Great West,* 534 U.S. at 204, 122 S.Ct. 708 (holding that equitable restitution allows recovery "where money or property identified as belonging in good conscience to the plaintiff *could clearly be traced* to particular funds or property in the defendant's possession." (emphasis added)). For a review of tracing rules, see generally Douglas Laycock, *Modern American Remedies* 673-78 (3d ed.2002) (summarizing tracing rules), and 1 George E. Palmer, *The Law of Restitution* § 2.14-.16, at 175-207 (1978) (describing tracing rules in more detail).

1. Misidentifying the restitutionary baseline

[16] The district court measured the appropriate amount of restitution as "the full amount lost by consumers." This was error. The appropriate measure for restitution is the benefit unjustly received by the defendants. *See Pereira v. Farace,* 413 F.3d 330, 340 (2d Cir.2005) (stating that "restitution is measured by a defendant's unjust gain, rather than by a plaintiff's loss" (internal quotation and alteration marks omitted)) (citing *Great-West Life & Annuity Ins. Co.,* 534 U.S. at 229, 122 S.Ct. 708 (Ginsburg, J., dissenting)); Restatement (Third) of Restitution § 2 (Discussion Draft 2000) ("Liability in restitution is based on and measured by the receipt of a benefit . . . ."); Douglas Laycock, *The Scope and Significance of Restitution,* 67 Tex. L.Rev. 1277, 1279 (1989) ("[R]estitution measures recovery by defendant's gain rather than plaintiff's loss"). Labeling the remedy "consumer redress" or "disgorgement," each a restitutionary remedy, does not alter the basic principle that restitution is measured by the defendant's gain.

*68 Undeniably, in many cases in which the FTC seeks restitution, the defendant's gain will be equal to the consumer's loss because the consumer buys goods or services directly from the defendant. Thus, in these cases it is not inaccurate to say that restitution is measured by the consumer's loss. But it is incorrect to generalize this shorthand and apply it as a principle in cases where the two amounts differ–for example, when some middleman not party to the lawsuit takes some of the consumer's money before it reaches a defendant's hands. Both the district court and the FTC in its brief adopt this fallacy, relying on shorthand from cases in which only one who sold directly to consumers was sued. *See FTC v. Febre,* 128 F.3d 530, 536-37 (7th Cir.1997) (direct seller sued); *FTC v. Gem Merch. Corp.,* 87 F.3d 466, 469- 70 (11th Cir.1996) (direct seller sued; court held that "disgorgement, the purpose of

which 'is not to compensate the victims of fraud, but to deprive the wrongdoer of his ill-gotten gain,' is appropriate"); *FTC v. Sec. Rare Coin & Bullion Corp.*, 931 F.2d 1312, 1316 (8th Cir.1991) (direct sellers sued); *FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564, 573-75 (7th Cir.1989) (direct sellers sued); *FTC v. Medicor, LLC*, 217 F.Supp.2d 1048, 1058 (C.D.Cal.2002) (direct sellers sued); *FTC v. Five-Star Auto Club, Inc.*, 97 F.Supp.2d 502, 534 (S.D.N.Y.2000) (measuring the "full amount lost by consumers" by the amount taken in by the defendant).[11]

This error manifested itself in the district court's calculation of the sum to be disgorged. For the AT&T Period, the district court determined that consumers paid AT&T $16.3 million for the relevant services (so-called videotext services). We uphold this determination but instruct the district court on remand to further consider how much of this sum was in fact received by the defendants-appellants and is therefore subject to an order of restitution. The cascading payment structure during the AT&T Period indicates that AT&T, AT&T U.K./Viatel, and Telecom Malagasy received some fraction of the money paid by consumers before any payments were made to the defendants-appellants. Only the remaining fraction of total billings unjustly enriched the defendants-appellants and may be the basis for a disgorgement remedy.

For the Sprint Period, the cascading payment structure flowed differently. The defendants-appellants received consumers' money through eBillit, and they paid Sprint, AT&T U.K./Viatel, Telecom Malagasy, and GIB from those unjustly

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[11] In another case cited by the FTC to support the monetary award, the court explicitly relied on the authorization of damages in § 19 of the FTC Act, not just on the court's equitable power, to allow a remedy under the FTC Act of more than the defendant's gains. *See FTC v. Figgie Int'l, Inc.*, 994 F.2d 595, 606 (9th Cir.1993).

received consumer funds. Thus, for the Sprint Period, the district court should determine the amount of the $1.6 million in total billings that the defendants-appellants received from eBillit, without deducting monies paid by the defendants-appellants to other parties. For both periods, the focus of the district court's restitution calculation should be on the defendants-appellants' unjust gains.

2. Prematurely shifting the burden of proof to the defendants-appellants

[17] The two-step burden-shifting framework for establishing the size of disgorgement relief requires the plaintiff to first "show that its calculations reasonably approximated" the amount of the defendant's unjust gains. *Febre,* *69128 F.3d at 535 (citing *Lorin,* 76 F.3d at 462). Here, because some fraction of consumers who paid the bills incurred through the defendants-appellants' billing system actually used or authorized others to use the services at issue, the amount of the defendants-appellants' *unjust* gains is only a fraction of the amount of their overall gains from the billing system. A reasonable approximation of the defendants-appellants' unjust gains must take this into account.

Although the district court recognized that restitution is based on unjust payments, not just overall payments, it never explained its basis for concluding that the overall sum collected through the billing system reasonably approximated the amount of unjustly obtained funds. Indeed, for the AT&T Period, the consumer declarations offered by the FTC (although not all considered by the district court because it found them unnecessary) indicate that AT&T gave a one-time credit to any caller who complained to AT&T about the charges. *See* Pl.'s Exs. 1, 82-92. No consumer declaration indicates that AT&T refused to provide a credit or refund. Therefore, unlike during the Sprint Period, there is little basis to conclude that unjust

gains were obtained from complaining customers during the AT&T Period (although this does not necessarily mean that every charge collected by AT&T was from a person who themselves accessed or authorized others to access an adult website). Accordingly, we do not think it reasonable to assume that total AT&T Period collections approximates the total amount paid by consumers who did not authorize use of the adult entertainment provided.[12]

Thus, because the district court did not first assess the reasonableness of the FTC's approximation of unjust gain, the district court was premature in shifting the burden of proof to the defendants-appellants, which in turn allowed the district court to invoke the principle that " '[t]he risk of uncertainty should fall on the wrongdoer whose illegal conduct created the uncertainty.' " *Febre,* 128 F.3d at 535 (quoting *SEC v. First City Fin. Corp.,* 890 F.2d 1215, 1232 (D.C.Cir.1989)). This presumption against the wrongdoer should not have been invoked without first establishing a reasonable approximation of unjust gain because this presumption applies only in the second stage of the burden-shifting framework. *See id.* at 535 (invoking the presumption to hold that the defendants could not satisfy *their* burden of proving the inaccuracy of the FTC's calculations); *First City Fin.,* 890 F.2d at 1232 (holding that the government satisfied its burden of providing a reasonable approximation of unjust enrichment and that defendants could not meet *their* burden of rebutting the government's calculations). If the law were otherwise, the FTC would be relieved at the first stage from submitting a reasonable approximation of unjust gain and could recover any amount that

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[12] Our objection does not translate to the Sprint Period, however, for which the reasonableness of the FTC's approximation is less doubtful. The evidence indicates that the customer-service center was a disaster during this period and that at least some consumers did pay for services for which they were improperly billed.

it chose to submit, however unreasonable, that fit within the presumption against the wrongdoer.

Of course, the reasonableness of an approximation varies with the degree of precision possible. But here, the district court required no precision in the FTC's approximation even though precision could be had. The FTC's investigatory power gives it the capacity to estimate with some degree of precision how many telephone-*70 line subscribers who paid the bills for adult entertainment did so despite not using or authorizing others to use such services.

* * * * * *

For the foregoing reasons, we vacate the monetary award of the district court's October 26, 2004 final order of relief and remand the case for further proceedings on the size of the disgorgement award. On remand, we direct the district court to revise its computations to focus on the benefits unjustly obtained by the defendants rather than the losses of consumers and to entertain only reasonable approximations of the defendants-appellants' unjust gains, rather than their overall gains, before shifting the burden to the defendants-appellants to refute the approximation, handicapped by the presumption against wrongdoer-created uncertainty.

VI. Contempt Sanctions

[18] The district court held defendants-appellants Green and Shein in contempt of court for failing to comply with a financial-disclosure requirement of the preliminary injunction and sanctioned them for the contempt by order filed May 2, 2001. The contempt sanctions imposed were coercive, intended to induce compliance with the financial-disclosure obligation by imposing per-day fines for noncompliance and ordering Green's and Shein's civil confinement until they completed the forms. *See generally United States v. United Mine Workers of*

Am., 330 U.S. 258, 303, 67 S.Ct. 677, 91 L.Ed. 884 (1947) ("Judicial sanctions in civil contempt proceedings may, in a proper case, be employed for either or both of two purposes; to coerce the defendant into compliance with the court's order, and to compensate the complainant for losses sustained.").

Green and Shein appeal from the contempt order, which we now vacate. Our reasoning is straightforward. The permanent injunction that dissolved and replaced the preliminary injunction does not itself contain a financial-disclosure requirement. The district court therefore no longer requires Green and Shein to do the act that the contempt sanctions coerce them do to. Thus, the sanctions must be vacated. *See Consol. Rail Corp. v. Yashinsky,* 170 F.3d 591, 596 (6th Cir.1999) (holding that the expiration of a judgment mooted the coercive per-day fines of a contempt sanction imposed for not satisfying the judgment); *see also Shillitani v. United States,* 384 U.S. 364, 372, 86 S.Ct. 1531, 16 L.Ed.2d 622 (1966) (ordering a contempt sanction vacated as moot on appeal from the sanction). Green and Shein are relieved of all fines imposed by the order and are no longer subject to civil confinement under its terms. Of course, nothing here prevents the FTC from moving in the district court on remand for an appropriate order to obtain the financial disclosure desired and from seeking a new set of sanctions if the district court's orders are subsequently disobeyed.

CONCLUSION

We affirm all components of the district court's October 26, 2004 final order of relief except for the monetary judgment contained therein, which we vacate. We also vacate the district court's May 2, 2001 contempt order. The case is remanded to the district court for further proceedings consistent with this opinion.

APPENDIX B

UNITED STATES DISTRICT COURT,
S.D. NEW YORK.

No. 00 Civ.7422(LAK)

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

VERITY INTERNATIONAL, LTD. *et al.*,

Defendants.

Sept. 17, 2004

MEMORANDUM ORDER

KAPLAN, District Judge.

Pornography and other adult material is one of the biggest businesses on the Internet. Operators of websites offering such content nevertheless struggle with the fact *484 that collecting for access to their wares can be problematic, especially with customers who are reluctant to send their credit card information off into cyberspace or who do not wish charges for such material to appear on credit card or other bills.

The remaining defendants in this case--Robert Green, Marilyn Shein, Automatic Communications Ltd. ("ACL"), and Verity International, Ltd. ("Verity") (collectively, the "defendants" or "ACL defendants")– hit upon a solution.[1] They

[1] The amended complaint named also as defendants Integretel, Inc. ("Integretel") and its subsidiary, eBillit, Inc. ("eBillit") (collectively, the "Integretel defendants"), which entered into a consent decree. *See FTC v.*

offered adult content website operators a service whereby defendants arranged to have customers billed for access by including the charges on the telephone bills for the telephone lines over which the customers accessed the Internet and describing the charges as being for telephone calls to Madagascar. When some customers balked at paying often large amounts for alleged telephone calls to Madagascar, defendants and those with whom they contracted insisted that the customers were responsible for any charges incurred on their telephones and demanded payment. But there were at least two fundamental problems.

First, the individuals who subscribed to the telephone lines to which the charges were billed often neither accessed, nor authorized anyone else to access, the adult content websites. Their telephone lines were used by others. But defendants insisted on payment notwithstanding.

Second, the telephone calls were not connected to Madagascar. Defendants arranged to have the calls "short-stopped" in London, where they were connected to the websites of their clients.

The Federal Trade Commission ("FTC") brought this action, claiming in essence that defendants violated Section 5(a) of the Federal Trade Commission Act (the "FTC Act") [2] by (1) representing that line subscribers were liable for, and demanding payment of, charges incurred on their telephone lines irrespective of whether the line subscribers themselves accessed, or authorized others to access, the websites, and (2) issuing bills that misrepresented the services provided by

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Verity Int'l, Ltd., No. 00 Civ. 7422(LAK) (S.D.N.Y. Nov. 21, 2002). A third-party complaint against AT&T also has been resolved.

[2] 15 U.S.C. § 45(a) (2004).

describing them as telephone calls to Madagascar when in fact they were for a package including access to Internet content and telephone calls to London. The FTC seeks principally a permanent injunction prohibiting Verity, Green and Shein from engaging in any capacity in the provision of audiotext or videotext services to U.S. consumers and prohibiting ACL from billing subscribers without express authorization. The case has been the subject of several previous opinions and orders, familiarity with which is assumed.[3]

*485 The parties agreed to a bench trial on a stipulated record consisting of declarations, exhibits, and other evidence.[4] This opinion contains the Court's findings of fact and conclusions of law.

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[3] *See FTC v. Verity Int'l, Ltd.*, No. 00 Civ. 7422(LAK), 2002 WL 1905983 (S.D.N.Y. Aug. 16, 2002) (denying without prejudice FTC's motion for summary judgment); *FTC v. Verity Int'l. Ltd.*, No. 00 Civ. 7422(LAK), 2002 WL 1446627 (S.D.N.Y. July 3, 2002) (denying defendants' summary judgment motions); *FTC v. Verity Int'l, Ltd.*, 194 F.Supp.2d 270 (S.D.N.Y.2002) ("*Verity III*") (extending preliminary injunction to defendant ACL); *FTC v. Verity Int'l. Ltd.*, No. 00 Civ. 7422(LAK), 2001 WL 504849 (S.D.N.Y. May 14, 2001) (modifying preliminary injunction); *FTC v. Verity Int'l, Ltd.*, 140 F.Supp.2d 313 (S.D.N.Y.2001) ("Verity II") (holding Green and Shein in civil contempt for failure to comply fully with preliminary injunction); *FTC v. Verity Int'l, Ltd.*, 124 F.Supp.2d 193 (S.D.N.Y.2000) ("Verity I") (granting FTC's motion for preliminary injunction); *FTC v. Verity Int'l, Ltd.*, No. 00 Civ. 7422(LAK), 2000 WL 1805688 (S.D.N.Y. Dec. 8, 2000) (continuing temporary restraining order).

[4] *FTC v. Verity Int'l, Ltd.*, No. 00 Civ. 7422(LAK) (S.D.N.Y. Aug. 15, 2002).

I

A. THE PARTIES

ACL and Verity are Bahamian corporations[5] that operated billing services for Internet pornographers.[6] The billing systems provided website operators with an alternative to collecting credit card information from users by engaging ACL or Verity, which in turn charged the person whose telephone line was used to connect to the Internet for access to the operator's site.[7]

Green and Shein were founders, principals, and major shareholders of both companies.[8] Each held 50 percent of Verity.[9] Each held 40 percent of ACL until September 20, 2000, when Oriel Communications Ltd. ("Oriel"), a publicly traded Australian corporation, acquired a 50 percent interest in the company.[10] As a result of the Oriel acquisition, Green and Shein each owned 20 percent of ACL shares and roughly 11 percent of Oriel shares.[11]

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[5] Pre-trial Order ("PTO") § III ¶ 2 (All subsequent references to the PTO, unless otherwise indicated, are to Section III, which contains stipulations of facts).

[6] PX 133 ¶¶ 2-3, 28 (Blanchard Decl.); PX 161 at 4-5 (Oriel, 2000 Annual Report); ACL Defs. SJ Mem. 26.

[7] PX 133 ¶ 27.

[8] PTO ¶¶ 5-6, 17-18, 21; PX 156 at 5 (Blanchard Decl.).

[9] PX 156 at 5.

[10] PTO ¶¶ 6, 8, 18.

[11] *Id.* ¶¶ 5, 15, 17, 20.

Green and Shein concede that they jointly controlled the acts and practices of ACL and Verity from the date the companies were incorporated up until September 18, 2000 and October 2, 2000, respectively.[12] Most of the companies' activities were based upon industry contacts that these two individuals developed over a ten-year period.[13]

ACL continued operations after the Oriel acquisition in September 2000 and became the key focus of Oriel's business operations.[14] Verity's operations, by contrast, were short-lived. It apparently began operations just prior to the Court's issuance of a temporary restraining order in October 2000 and ceased all operations soon afterward.[15]

B. BASIC OPERATION OF THE BILLING SYSTEM

The billing system at the center of this litigation operated in the following way. A computer user who was logged onto the Internet through an Internet service provider ("ISP") would visit a website providing adult content.[16] The website would

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[12] *Id.* ¶¶ 22-23.

[13] *See* PX 154 ¶¶ 2, 19 (Green Decl.); PX 155 ¶¶ 2, 14 (Shein Decl.).

[14] PX 161 at 4.

[15] PX 156 ¶ 3.

[16] PX 133 ¶ 28. Although defendants indicate that their billing system could have been used to provide any type of web content, not just pornography, they do not dispute that the websites in question exclusively carried adult content. *See* ACL Defs. SJ Mem. 26; *see also* Chacon Dep. 15 (Shein told eBillit representative that websites provided adult entertainment); Calgano Dep. 51 (Shein made same representation to Integretel representative).

offer the user an opportunity to purchase additional web content using a dialer program.[17]

*486 If the user selected the dialer option, the website presented the user with a disclosure containing the terms and conditions of use.[18] The disclosure identified the per minute rate for access and explained that charges would appear on the line subscriber's phone bill as an international telephone charge.[19] If the user affirmatively agreed to these terms and conditions by clicking a box that read, in substance, "I agree" or "I accept,"[20] a dialer program was downloaded onto the user's computer.[21] The user then initiated the dialer by clicking another icon.[22] The dialer thereupon disconnected the user's modem from the ISP and placed a long-distance telephone call to a Madagascar telephone number.[23]

The calls did not in fact go through to Madagascar. They were connected instead to Internet servers in the United Kingdom (i.e., the calls were "short-stopped").[24] The website operator then sent web content over the phone lines to the

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17 PX 133 ¶ 28. The website might offer also the alternative of paying by credit card. *Id.*

18 PTO ¶ 28.

19 PX 151B at 10-20 (Green Decl.); *see also* PX 133 ¶ 28.

20 PTO ¶ 28.

21 PX 133 ¶ 28.

22 *Id.*

23 *Id.*

24 Interr. No. 4; PX 133 ¶ 28.

caller.[25] The dialer program caused the cost of accessing these services to be billed to the subscriber whose line was used to place the Madagascar phone call, regardless of whether the subscriber was the person who used the services.[26] The subscriber whose line was used to access the services was identified through an automatic number identification ("ANI") system, which is the system used by carriers such as AT&T to bill for ordinary phone calls.[27]

[1][2] Initially, the charges appeared on the subscribers' telephone bills as charges for long-distance calls to Madagascar.[28] Later, defendants sent subscribers separate bills

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[25] *See* PX 133 ¶ 28.

[26] *See* PX 151B ¶ 9; PX 133 ¶ 28; P.I. Hrg. Tr. 95-96.

[27] PX 133 ¶ 28; PX 151B ¶ 28; P.I. Hrg. Tr. 95-96.

[28] *See* PX 133 ¶ 15; PX 83 at 4 (AT&T bill); PX 86 at 7 (same); PX 89 at 4 (same); PX 91 at 5 (same). The cited bills are attached to consumer declarations that defendants objected to on hearsay grounds. *See infra* note 78. Even if the statements in the declarations are inadmissible hearsay, the bills have sufficient distinctive characteristics to be authenticated under *Federal Rule of Evidence* 901(b)(4), which provides that authentication may be established by "appearance, contents ... and other distinctive characteristics, taken in conjunction with the circumstances." Here, the bills were collected from customers and contain the typical features of a telephone bill, such as the billing company's logo, a list of the calls being billed, and the consumer's account information. These features and circumstances are sufficient to establish the authenticity of the bills. Moreover, the bills are not subject to a hearsay objection because they are not offered to prove the truth of the matters asserted, but instead to prove that the statements contained in the bills were made.

In any case, the Court infers, and therefore finds, on the basis of stipulations and admissions, that (1) AT&T billed the Internet services provided by defendants' clients as telephone calls to Madagascar, and (2) AT&T told consumers that they were legally obligated to pay for such services, irrespective of whether they made or authorized the calls. *See, e.g.*,

for the services, but continued to represent that the calls terminated in Madagascar.[29]

C. ACL DEVISES AND IMPLEMENTS THE BILLING SYSTEM

A principal point of contention between the parties is the extent of defendants' role in the billing system described above. The defendants attempt to minimize their role by assigning blame to the carriers, billing and collection agencies, information providers ("IPs") or website operators.[30] But the Court finds that the ACL defendants devised, implemented, and controlled the system by entering into a series of agreements with carriers, IPs, and billing and collection agents.[31]

1. The Telecom Malagasy Agreement

The ACL billing system began to take shape in May 1997, when ACL obtained exclusive rights from Telecom Malagasy ("TM"), the official telecommunications carrier for Madagascar, to carry calls to a range of telephone numbers that

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PTO ¶¶ 38-45; Adm. Nos. 44-51.

[29] PX 133 ¶ 15; PX 1 at 3 (Verity bill); PX 6 at 2 (same).

[30] *E.g.*, PTO Ex. A at 3-11.

[31] Despite defendants' representations that ACL played a minimal role in the billing system, representatives of ACL and Verity described the companies as providers of dialer billing systems. *E.g.*, PX 133 ¶ 28 (Blanchard Decl.) (describing how the "dialer service provided ACL" operates); PX 151B ¶ 2 (Green Decl.) ("Verity operates a billing mechanism which affords consumers seeking access to various websites the convenience and privacy of allowing the access fee to be charged to the consumer's telephone bill, rather than the consumer's credit card."); PX 161 at 4 (Oriel, 2000 Annual Report) (ACL specializes in providing "[d]ialer billing systems [that] enable consumers to be charged for access to websites to the telephone line being used by their computer modem.")

had been assigned to Madagascar for international telephone connections.[32] The agreement authorized ACL to arrange for the carriage of traffic to those numbers, to terminate the calls at any location of ACL's choosing (including locations outside Madagascar), and to receive revenues for those calls.[33]

2. The IP Agreements

The next pieces to ACL's billing system were its agreements with IPs. ACL contracted with Global Internet Billing, Inc. ("GIB"), and possibly other IPs, to market dialer billing programs that contained the phone numbers assigned to ACL.[34] Under an agreement with ACL dated February 23, 2000, GIB agreed to market the information services associated with the telephone numbers and to use its best efforts to generate an agreed upon volume of usage to those numbers.[35] ACL in turn agreed to pay GIB a fee based upon the usage minutes.[36] A subsequent amendment, dated March 31, 2000, provided that ACL must authorize services that used the

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[32] *See* PTO ¶ 24; PX 157A; PX 133 ¶ 5.

[33] PX 157A Ex. 1.

[34] PTO ¶¶ 31-32.

[35] PX 157A Ex. 2; PX 150 at 13. Although the agreement identifies the contracting parties as GIB and Western Connections (as opposed to ACL), defendants have represented that the agreement was between GIB and ACL. *E.g.*, ACL Defs. SJ Mem. 5 ("ACL entered into an agreement with GIB, whereby ACL would provide GIB with the Madagascar number ranges to insert into the dialer program ..."); PX 157A ¶ 7 (Blanchard Decl.) (attaching "true and complete" copy of "ACL's agreement with GIB"). According to defendants, Western Connections was an affiliate of ACL. *See* ACL Defs. 56.1 ¶ 35.

[36] PX 157A Ex. 2.

numbers for modem dialing and granted ACL some authority to approve disclaimers.[37] ACL did not itself create or provide web content.[38]

3. The Carrier Agreements

(a) The AT&T Agreement

The other components to ACL's billing system were its agreements with originating carriers--first AT&T and then Sprint--to carry, bill for, and collect on the calls.[39] In January 1999, ACL entered into an agreement with AT&T and AT&T U.K. (later known as Viatel) for the carriage and termination of traffic to the Madagascar telephone numbers assigned to ACL.[40] AT&T agreed to send the calls to AT&T U.K.'s London facilities, which would accept the calls on a transit basis and forward them to ACL for termination in Madagascar.[41]

The agreement further provided that payments be made in a "cascade arrangement."[42] AT&T would pay to AT&T U.K. the amounts due to both AT&T U.K. and ACL, and AT&T

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[37] PX 150 at 13.

[38] PTO ¶ ¶ 29-30.

[39] In order to bypass the line subscriber's designated carrier, the dialer placed the call using a dial-around sequence in the format 10- 10-CIC, where CIC represented the unique identification code of the carrier chosen by ACL. Fox Dep. 32-33; McHale Dep. 41-42.

[40] PTO ¶ 34; PX 151A.

[41] PX 151A at 2.

[42] PTO ¶ 45; PX 151A at 6-7.

U.K. in turn would pay ACL.[43] AT&T would set prices for the calls.[44] ACL, Green, and Shein knew that AT&T, either directly or through local exchange carriers ("LECs"), would disseminate, attempt to collect on, and handle consumer complaints regarding bills for calls to the Madagascar numbers assigned to ACL.[45]

(b) The Sprint Agreement

In July 2000, after discovering that ACL's lines were being used to carry videotext,[46] AT&T promptly terminated the contract and ceased carrying calls.[47] ACL quickly entered into an agreement with Sprint, on July 11, 2000, for Sprint to carry, bill for, and collect on the calls.[48] The agreement provided that Sprint would carry the calls to ACL, which would carry, or utilize others to carry, the calls for termination in Madagascar.[49] Sprint would pay a portion of the monies it collected to ACL.[50]

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[43] PX 151A at 6-7.

[44] *Id.* at 3.

[45] PTO ¶¶ 39, 42.

[46] For purposes of this opinion, videotext refers to information services provided via the Internet. See FTC SJ Mem. 4; ACL Defs. SJ Mem. 5. Calls carrying videotext are the only type of calls at issue in this litigation.

[47] Verity III, 194 F.Supp.2d at 284; see also PTO ¶¶ 35-38; PX 128 ¶ 3.

[48] PX 203.

[49] *Id.* at 1.

[50] *Id.* at 3.

The Sprint agreement recognized that calls would be made using a dialer program that provided access to entertainment services. ACL there represented that it "owns internet/based [sic] dialer software that it licenses to third parties for entertainment services."[51] The agreement required ACL to incorporate into the dialer software at least two specifically-worded disclaimers, both of which would be displayed to the consumer before the Madagascar number was dialed.[52] The disclaimers stated, in substance, that the dialer would place a long-distance call to Madagascar that would be billed to the user's phone bill.[53]

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[51] *Id.* at 8.

[52] *Id.*

[53] The first disclaimer stated:

> "By clicking on this icon, you will be disconnected from your internet provider and will be connected to another service provider via an international call. Most services cost $3.99 per minute, which charge will appear on your telephone bill. (Some services will cost more, as described more fully in the next screen should you continue)."

The second disclaimer stated:

> "WARNING: BY CLICKING ON THE 'I ACCEPT' BUTTON, YOU WILL DOWNLOAD SOFTWARE THAT WILL CAUSE YOUR COMPUTER MODEM TO DIAL AN INTERNATIONAL LONG-DISTANCE TELEPHONE CALL TO MADAGASCAR, AFRICA. NO CREDIT CARD WILL BE REQUIRED TO ACCESS THIS SERVICE. MOST CUSTOMERS WILL BE CHARGED $3.99 A MINUTE ON THEIR PHONE BILL FOR AN INTERNATIONAL CALL. SOME CUSTOMERS, DUE TO THEIR CALLING PLAN, WILL BE CHARGED UP TO $8.00 PER MINUTE.

*489 Although Sprint originally agreed to bill and collect for charges, it never did so. The parties entered a settlement agreement on August 16, 2000 that called for an end to the July 11 agreement on or before September 18, 2000.[54] The settlement agreement released Sprint from its billing and collection responsibilities, but permitted ACL to perform these activities so as long as ACL followed certain protocols.[55] For example, ACL agreed to charge users no more than $3.99 per minute and to use customer-friendly collection practices.[56] In addition, the agreement required ACL to pay Sprint a per minute transport fee.[57] Sprint agreed to provide ACL with the ANI information needed to identify the subscribers whose lines had been used to call the Madagascar phone numbers.[58]

The settlement agreement stated that Sprint was induced to sign only upon ACL's warranting that the calls were actually being terminated inside Madagascar.[59]

> IF YOU HAVE ANY QUESTIONS AS TO THE EXACT RATE THAT APPLIES TO YOUR CALL, PLEASE CALL 1- 800 ___. BILLING WILL BEGIN UPON CONNECTION IN THE FOREIGN COUNTRY. THE INTERNATIONAL NUMBER CALLED IS 261-7-0000 TO 9999...."

Id. at 8.

54 PX 204 at 1, 7.

55 *Id.* at 2.

56 *Id.*

57 *Id.* at 8.

58 *Id.* at 2.

59 *Id.* at 1.

4. The eBillit Agreement

After Sprint declined to bill for the ACL traffic, ACL made other arrangements to bill for the calls. On August 21, 2000, Verity entered into an agreement with eBillit whereby eBillit would prepare and mail bills, collect payments, and handle consumer inquiries.[60] Integretel and eBillit in turn subcontracted Output Services Group ("OSG") to perform printing and mailing, and ICT Group ("ICT") to provide customer service.[61]

5. Cascade Payment Arrangement

The result of all these agreements was a cascade payment arrangement whereby money flowed from consumers and ultimately to defendants and their client website *490 operators. Consumers would pay AT&T, which would pay AT&T U.K. (later Viatel), which in turn would pay ACL. ACL then would pay GIB, which in turn would pay website operators.[62] This was the intended structure also of the Sprint arrangement.

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[60] PX 184. Green and Sheen negotiated the agreement on behalf of ACL, but Green arranged for the agreement to be in Verity's name, not ACL's, on the day the agreement was signed. *See* PX 191 (email from Green to Calgano on August 21, 2000) ("Our accountants have advised us to put the billing into one of our subsidiary companies. Would this present any problems to you? If not would you produce the contract in the name of 'Verity International Ltd' (VIL) and we can sign it today."); Calgano Dep. 131-35. Tellingly, the agreement named ACL (not Verity) as the recipient of net proceeds collected under the agreement. *See* PX 184 at 5, 18. Integretel also replaced its name with that of its subsidiary, eBillit, in the final agreement, even though negotiations were conducted on the parent's behalf. Calgano Dep. 131-32.

[61] *See* PTO ¶¶ 52-53.

[62] ACL Ex. 31.

Green[63] and Shein [64] were instrumental in setting up all these relationships, which were at the center of the ACL billing system.

D. The Operation of the System

1. The AT&T Period

Between January 1999 and July 23, 2000, AT&T, either directly or through its LECs, carried, billed for, and collected on calls placed to ACL's numbers.[65] Not all of the calls during this period were for videotext. IPs did not begin using ACL's phone numbers to provide videotext until approximately

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[63] *See, e.g.*, PX 154 ¶ 19 (Green Decl.) ("Most of ACL's activities for the period before and after [the first seven months of 2000] consisted of various telecommunications and billing transactions based on contacts that Marilyn [Shein] and I have developed over the years in the industry, and in particular, our access to exchange numbers in certain parts of the world, including Madagascar."); PX 151A at 14 (Green signed AT&T agreement on behalf of ACL); Dooley Dep. 17-20 (Green helped negotiate agreement with Sprint); PX 203 at 7 (Green signed Sprint agreement on behalf of ACL); Fox Dep. 80-81 (Green met with GIB representative to discuss ways of stimulating traffic); PX 201 (Green initiated contact with Integretel); PX 230 (Green helped negotiate agreement with Integretel); PX 184 at 16 (Green signed eBillit agreement on behalf of Verity).

[64] *See, e.g.*, PX 155 ¶ 14 (Shein Decl.) ("Most of ACL's activities for the period before and after [the first seven months of 2000] consisted of various telecommunications and billing transactions based on contacts that Robert [Green] and I have developed over the years in the industry, and in particular, our access to exchange numbers in certain parts of the world, including Madagascar."); Dooley Dep. 17-20 (Shein helped negotiate agreement with Sprint); Calgano Dep. 18, 23-29, 35-37 (Shein helped negotiate agreement with Integretel); *Id.* at 191 (Shein discussed with Integretel outsourcing of calls).

[65] PTO ¶ 38; P.I. Hrg. Tr. 49-50

January 2000 and continued to do so through July 23, 2000 (the "AT&T Period").[66]

For billing and collection, AT&T treated the ACL traffic no differently than it treated other residential phone calls.[67] For example, the charges appeared on subscribers' monthly telephone statements as charges for long-distance telephone calls, with Madagascar identified as the "place called."[68] The bills stated that failure to pay might result in disconnection of services and further collection activity.[69]

In addition, AT&T charged subscribers the same rate that it charged under its applicable tariff for genuine phone calls to Madagascar.[70] It billed on the basis of *491 ANI information,[71] thereby billing the calls to subscribers from whose lines the

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[66] The parties dispute whether IPs began using ACL's numbers to provide videotext in January, February or March 2000. Compare FTC 56.1 ¶ 31 *with* ACL Defs. Opp. to FTC 56.1 ¶ 31. The number of minutes AT&T billed remained steady during the last six months of 1999 but then doubled in January 2000, and again in February 2000 (*see* PX 128 Ex. A) (Bolin Decl.), indicating that videotext service probably began in January 2000. Cf. PX 161 at 4 (attributing ACL's surge in billings for the 12-month period ending June 2000 to the successful commercialization of its dialer billing system).

[67] McHale Dep. 67-69.

[68] *See* PX 83 at 4; PX 86 at 7; PX 89 at 4; PX 91 at 5.

[69] *See* PX 83 at 4 ("[N]onpayment of toll charges may result in disconnection of local service, and other services may be restricted if not paid.... Unpaid accounts also may be subject to collection action."); PX 86 at 7 (same); PX 89 at 4 (same); PX 91 at 5 (same).

[70] PTO ¶ 41.

[71] *Id.* ¶ 43.

calls were placed, regardless of whether they made or authorized the calls.[72] Further, it used the same personnel and the same processes to handle ACL calls as it used for all other residential calls.[73] The ACL defendants had no input into ACL's billing and collection process.[74]

After IPs began using the ACL billing system to carry videotext, AT&T experienced a surge in the volume of calls to Madagascar. AT&T billed $28,975,336 for the calls in 2000, compared to $1,643,111 in 1999.[75] AT&T's adjustments for contested bills also increased dramatically, from 8 percent (or $130,005) of total billings in 1999 to 38 percent (or $11,138,773) of total billings in 2000.[76] ACL received $2,088,031 in 1999 and $8,620,902 in 2000.[77]

[3] The parties agree that at least some of the subscribers who received bills were users of ACL's dialer program, but none of the parties knows how many.[78] Nor do the parties

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[72] *See* P.I. Hrg. Tr. 95-96.

[73] McHale Dep. 67-70.

[74] *Id.*

[75] PX 128 Ex. A.

[76] *Id.*

[77] PX 157 at 7 (Sinclair Decl.).

[78] PTO ¶ ¶ 59-60. The FTC offered eleven declarations from consumers who received bills during the AT&T Period, primarily to show that at least some line subscribers were charged for calls to Madagascar that they neither made nor authorized. *See* PX 82 through PX 92. Defendants objected to these declarations on hearsay grounds, and the FTC contends that the declarations are admissible under the residual exception to the hearsay rules, *Fed. Rule of Evid.* 807. But the issue ultimately is immaterial. Without consideration of the declarations, the Court finds for the FTC.

know how much of the amount billed was for videotext services. Defendants argue that the amount that AT&T billed in 2000 may be divided equally between videotext and other calls.[79] This estimate of videotext, however, is excessively low. According to Oriel's public filings at the time, the "bulk" of ACL's service charges were for videotext.[80]

2. The Sprint Period

Sprint carried calls to the Madagascar numbers assigned to ACL from July 11, 2000 through September 2000 (the "Sprint

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The FTC offered 81 additional consumer declarations relating to the Sprint Period. See PX 1 through PX 81. Defendants waived a hearsay objection to 22 of these declarations, *see FTC v. Verity Int'l Ltd.*, No. 00 Civ. 7422(LAK) (S.D.N.Y. Aug. 5, 2002) (order signing stipulation for presentation of trial evidence), but objected to them on relevancy grounds. These declarations, however, are of obvious relevance to, *inter alia*, the FTC's claim that defendants billed line subscribers for calls that they neither made nor authorized. *See* PX 1; PX 3; PX 6; PX 7; PX 8; PX 9; PX 11; PX 12; PX 14; PX 15; PX 17; PX 18; PX 20; PX 30; PX 31; PX 39; PX 40; PX 41; PX 42; PX 46; PX 53; PX 71 (hereinafter, "Admitted Consumer Decls."). As the 59 consumer declarations to which defendants objected on hearsay grounds are redundant and cumulative, the Court does not consider them in reaching its decision.

[79] *See* PX 157 at 5.

[80] PX 161 at 5 (Oriel Annual Report for year ending June 2000); *see also id.* at 4 (attributing ACL's rapid business growth in 2000 "primarily to ACL's successful commercialization of dialer billing systems for website access.")

Period").[81] The Integretel defendants *492 handled billing and collection for this traffic.[82]

The bills sent to consumers during the Sprint Period were mailed separately from the consumers' regular telephone bills.[83] The first page included a summary of the charges, at the bottom of which appeared the "Total Amount Due."[84] The top right corner of the bill identified the invoice number, the account number, the due date, and the total due.[85] Consumers were instructed to make checks payable to Verity.[86] Under the heading "INTERNET BILLING," the bill stated that "THIS BILL ACCOUNTS FOR INTERNATIONAL CALLS, FROM YOUR MODEM TO A MADAGASCAR NUMBER, FOR WEBSITE ACCESS."[87] On the bottom right corner of the bill appeared a 1-800 number for consumers to call with questions about their invoices.[88] The second page of the bill provided a list of details about each call, including date, time, destination (Madagascar), the telephone number called, the duration, and

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[81] *See* PX 203; PX 133 ¶ 28; PX 204; Dooley Dep. 63-64. Sprint may have carried residual traffic for several weeks after September 25, 2000, when it terminated the agreement. *See* Dooley Dep. 63-64. Also, AT&T and Sprint may have carried traffic during the overlapping period between July 11, 2000 and July 23, 2000.

[82] *See* PTO ¶ ¶ 49, 52-53.

[83] *See* Admitted Consumer Decls., supra note 78.

[84] *Id.*

[85] *Id.*

[86] *Id.*

[87] *Id.*

[88] *Id.*

the charges per call. Green approved the final format of the bill.[89]

eBillit and its vendor sent 91,683 bills for July and August services totaling $11,664,986 in the period September 14-20, 2000.[90] They sent no other bills.[91] As did AT&T, the Integretel defendants billed the ACL traffic on the basis of ANI information, which Sprint provided pursuant to its agreement with ACL.[92] Subscribers thus were billed regardless of whether they made or authorized the calls.

The Verity bills prompted thousands of consumer complaints. At least 24,986 consumers contacted eBillit or its vendor about the Verity bills.[93] The FTC received 548

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[89] Calgano Dep. 128-29.

[90] PTO ¶ 54; PX 133 ¶ 17. Calls were billed at $3.99 per minute, the same rate that Sprint charged under its applicable tariff for genuine calls to Madagascar. PTO ¶ 47; PX 133 ¶ 28; Admitted Consumer Decls., *supra* note 78.

[91] Calgano Dep. 88, 100.

[92] PTO ¶¶ 49-50.

[93] PX 334 (Calgano Decl.). Although the record does not indicate what percentage of these consumers contacted eBillit in order to dispute the charges, the evidence suggests a substantial number. Defendants eventually gave adjustments to 8,651 (35 percent) of the subscribers who contacted them. *See id.* According to eBillit's records, the vast majority of these adjustments (89 percent) were given to consumers who denied making or authorizing the calls to Madagascar. *See id.* Moreover, the number of consumers who contacted eBillit to dispute the charges was likely much higher, as some consumers who tried calling reached a busy signal, despite multiple attempts. *See infra* note 111.

complaints about Verity during the period September 18 through September 22, 2000.[94]

Consumers who attempted to contact eBillit or its vendor to dispute the charges, particularly those who did so prior to the FTC's filing of this action, had little success in obtaining adjustments.[95] Most consumers who tried were unable to get in touch with the call center. Calls to the 1-800 number were routed to ICT's call center in Lakeland, Florida,[96] which was ill-equipped to handle the large volume of *493 calls.[97] As a result, some callers reached a busy signal and were unable to get through, despite numerous attempts.[98] During the week of September 18 (the first full week in which the call center handled inquiries about Verity bills), callers who did not get a busy signal waited an average of over 19 minutes to speak with a representative, and 72 percent of the calls made to the 1-800

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94 *Verity I*, 124 F.Supp.2d at 197.

95 *See* PX 285; Chacon Dep. 97-103; PX 334.

96 Calgano Dep. 22.

97 Chacon Dep. 90-91, 97-103; PX 285.

98 *See, e.g.*, PX 1; PX 3; PX 6; PX 7; PX 8; PX 9; PX 11; PX 14; PX 15; PX 16; PX 17; PX 18.

nur.b r were abandoned.[99] Some callers waited more than an hour.[100]

Those callers who succeeded in speaking with customer service representatives ("CSRs") faced yet another hurdle. At Verity's direction, the call center implemented a "hard sustain" approach to handling consumer calls.[101] Callers who waited to speak with a CSR were played a recording that warned that "[f]ailure to pay a Verity International bill may result in the blocking of your phone line to services of this nature from a variety of content providers and further collection activity of past due amounts."[102] In addition, CSRs were instructed to withhold adjustments until after a two-minute "sustain period," to limit adjustments to a one-time courtesy of no more than 50 percent, and to advise callers that the charges were valid and must be paid and that nonpayment would subject the subscriber to further collection activity.[103] The call center monitored

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[99] Chacon Dep. 97-103; PX 285. In September 2000, 21,187 of the 35,421 calls made to the call center (60 percent) were abandoned, and callers who did not abandon their calls waited an average of over twelve minutes to speak with a customer service representative. Chacon Dep. 97-103; PX 285. In October 2000, 8,408 of the 20,239 calls made to the call center (42 percent) were abandoned, and callers who did not abandon their calls waited an average of over two minutes to speak with a customer service representative. Chacon Dep. 97-103; PX 285. It is unclear whether these statistics, provided by defendants, include calls that were answered by a busy signal.

[100] PX 285.

[101] Chacon Dep. 66-67.

[102] PX 282; Chacon Dep. 90-92.

[103] PX 275; PX 276; Chacon Dep. 32-36, 72-77.

CSRs to ensure their compliance with these rules.[104] Green and Shein worked with the call center to implement this approach.[105]

Not until after the FTC brought this action did the ICT call center soften its approach to handling consumer complaints. CSRs were permitted to grant one-time 100 percent courtesy adjustments, and were required to do so after a 2- minute sustain period.[106] In addition, CSRs were prohibited from telling consumers that nonpayment would result in further collection activity.[107] But even after ICT changed its policy for handling consumer complaints, some CSRs continued to grant only 50 percent adjustments, even for subscribers who denied making or authorizing the calls.[108] Nevertheless, the FTC's action did prompt an increase in adjustments. Prior to the FTC's action, *494 only 3 percent of the 11,799 consumers who disputed the charges received adjustments, compared with 63 percent of the 13,187 consumers who did so after the FTC's action.[109]

Most of the consumer declarations in evidence contain the personal accounts of line subscribers who received bills for

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[104] Chacon Dep. 55-58.

[105] PX 275 (email from Green approving instructions given to CSRs); Chacon Dep. 27-35 (Green approved instructions given to CSRs); *id.* at 72-77 (Shein reiterated to call center that it follow hard sustain approach); *id.* at 90-92 (Shein approved phone recording).

[106] PX 286; Chacon Dep. 108-09.

[107] PX 286; PX 287; Chacon Dep. 108-09.

[108] Chacon Dep. 113.

[109] PX 334.

calls that they neither made nor authorized.[110] Many of these consumers tried to call Verity numerous times but received busy signals.[111] Those who eventually succeeded in connecting to a CSR first were put on hold for significant times, only to be told that the bills must be paid.[112] Some consumers tried to find an alternative phone number for Verity by calling directory assistance in San Jose, California.[113] These callers were put through to a different company, similarly named Verity, which (perhaps in response to a substantial number of calls) played a recorded message explaining that it was unaffiliated with Verity International and providing callers with contact information for the FTC.[114]

By the end of this billing disaster, 19,544 consumers who had received a Verity bill paid $1,616,678 in response to bills that were mailed on Verity's behalf.[115] As is true of the AT&T Period, neither the FTC nor any of the defendants knows the number of subscribers that made or authorized the calls for

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[110] *See, e.g.*, PX 6; PX 8; PX 9; PX 11; PX 14; PX 15; PX 17; PX 18; PX 30; PX 40; PX 41; PX 42; PX 53.

[111] *E.g.*, PX 3 (called approximately 30 times a day for five days); PX 6 (called at least 20 times at various hours during one week); PX 11 (called approximately 30 times over several days).

[112] PX 1 at 2 (put on hold for 40 minutes); PX 3 at 1 (put on hold for 35 minutes).

[113] PX 1; PX 6; PX 7; PX 8; PX 9; PX 11; PX 14; PX 15; PX 20; PX 30.

[114] PX 1; PX 6; PX 7; PX 8; PX 9; PX 11; PX 14; PX 15; PX 20; PX 30.

[115] PTO ¶ 55.

which they were billed.[116] Of the 19,544 customers that made payments, 6,248 made an inquiry, and some received an adjustment of less than the full amount.[117] These 6,248 persons paid $573,811 of the $1.6 million collected in response to the Verity bills.[118]

II

The FTC asserts four claims for relief, all under Section 5(a) of the FTC Act.[119] Count I alleges that defendants engaged in a deceptive practice by misrepresenting, or causing others to misrepresent, that line subscribers were legally obligated to pay for videotext services, irrespective of whether they used or authorized use of those services. Count II alleges that these misrepresentations constituted an unfair practice. Count III contends that defendants engaged in a deceptive practice by causing bills to show that calls terminated in Madagascar, when in fact the calls were short-stopped elsewhere. Count IV asserts that defendants deceptively failed to disclose, or failed to ensure that others disclosed, in a clear and conspicuous manner the cost of connecting to videotext services through the ACL billing system.

A. FTC Jurisdiction

Defendants argue that ACL is a common carrier and therefore outside the FTC's jurisdiction.[120] This Court previously *495 addressed this contention and concluded that

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116 *Id.* ¶ 59.

117 PX 334.

118 *Id.*

119 15 U.S.C. § 45(a).

120 PTO Ex. A. ¶ 1.

"the ACL activities at issue in this case are [not] common carrier activities within the meaning of the Communications Act."[121] As the facts considered by the Court in reaching that conclusion have not changed,[122] the prior holding is dispositive.

B. Deceptive Practices

[4] Section 5(a) of the FTC Act declares unlawful any "unfair or deceptive acts or practices in or affecting commerce."[123] To establish that an act or practice is deceptive under Section 5(a), the FTC must demonstrate "a material representation, omission, or practice that is likely to mislead consumers acting reasonably in the circumstances."[124]

1. Legal Obligation to Pay (Count I)

To prevail on its first claim for relief, the FTC must establish that (1) the defendants represented, or caused others to represent, to line subscribers that they were legally obligated to pay irrespective of whether they used or authorized use of the Internet services provided by defendants' clients, and (2) the representation was materially false or deceptive.

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[121] *Verity III*, 194 F.Supp.2d at 277.

[122] *See id.* at 274-77.

[123] 15 U.S.C. § 45(a).

[124] *Verity I*, 124 F.Supp.2d at 200 (citing *FTC v. Pantron I Corp.*, 33 F.3d 1088, 1095 (9th Cir.1994), *cert. denied*, 514 U.S. 1083, 115 S.Ct. 1794, 131 L.Ed.2d 722 (1995); *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1029 (7th Cir.1988); *FTC v. Five-Star Auto Club, Inc.*, 97 F.Supp.2d 502, 526 (S.D.N.Y.2000)).

(a) The Representations

[5] During the AT&T Period, consumers were charged for using the services of defendants' clients through regular monthly telephone bills. These bills stated that nonpayment might result in disconnection of telephone service and further collection activity.

Defendants argue that they are not liable for these representations because defendants did not contribute to the format or content of the AT&T bills. But the fact that AT&T used its standard telephone bills, unaltered by defendants, was a valuable and intended feature of defendants' overall scheme. Defendants knew that AT&T would bill for the services as if they were genuine telephone calls to Madagascar on regular monthly telephone statements. In this way, defendants deliberately capitalized on the common and well-founded perception held by consumers that they must pay their telephone bills, irrespective of whether they made or authorized the calls being charged.

[6] Although the charges did not appear on subscribers' regular phone bills during the Sprint Period, the Verity bills featured all the characteristics of, and conveyed the same message as, a regular phone bill. The bills stated that the charges were for international phone calls and provided details about each call, including the date, time, destination (Madagascar), telephone number called, and duration. They included an account number, a total amount due, and a due date, and they instructed consumers to mail their payments to Verity. Recipients reasonably would have understood these bills to represent that the charges in fact were due and owing and that the addressees were obliged to pay or face the consequences that normally ensue from failure to pay a telephone bill.

Moreover, the call center reiterated the message. The recording that was played *496 to callers who were put on hold warned that failure to pay might result in blocking of their phone lines to (obscurely) "services of this nature" as well as further collection activity. Also, CSRs told consumers that the charges were valid and must be paid. Even though the call center may have instructed CSRs to modify their approach to handling calls after the FTC filed its lawsuit, there is no indication that any consumers were told that they were not legally obligated to pay if they had not used or authorized use of the services.

Defendants contend that, since eBillit performed billing and collection during the Sprint Period, they are not liable. The Court is not persuaded. Defendants contributed to, approved and supervised the methods that eBillit and its subcontractors used. The format of the bills, the audio voice recording, and the instructions given to CSRs all received defendants' approval.

In all the circumstances, the Court finds that defendants represented that line subscribers were legally obligated to pay these charges irrespective of whether they used or authorized use of the services of defendants' website clients.

(b) Falsity

The next issue is whether line subscribers who neither used nor authorized use of the services of defendants' clients were legally obligated to pay. If they were not, then defendants' representations were materially false.

[7] Defendants argue that line subscribers were legally obligated to pay, irrespective of whether they accessed or authorized access to the services of defendants' clients, under the filed rate doctrine, which holds that telephone subscribers are legally obligated to pay for calls made from their telephone

lines regardless of whether the subscribers themselves made or authorized the calls.[125] The filed rate doctrine does not apply here. This Court previously has explained the difficulty with defendants' position:

> "The FCC long has distinguished between basic telecommunications carriage – principally ordinary telephone and long distance service – and enhanced services such as those offered by Verity's clients. In Amendment of Section 64.702 of the Commission's Rules and Regulations, for example, the FCC declined to institute comprehensive regulation for enhanced services and found that vendors of enhanced services, defined as anything more than basic transmission service, were not engaged in common carrier activity. The Telecommunications Act of 1996 likewise distinguishes between telecommunications services and information services, stating that 'a telecommunications carrier shall be treated as a common carrier under this chapter only to the extent that it is engaged in providing telecommunications services.' While basic communications services long have been covered by filed tariffs, enhanced and information services have not. Thus, there appear to be no tariffs governing the rates or the terms and conditions upon which these services are offered. At any rate, defendants have pointed to none."[126]

Here, defendants provided more than basic transmission service. They operated a system that effectively collected charges for web content. The system included both content and a package of services that involved, among other things,

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[125] *Verity I*, 124 F.Supp.2d at 200-02 (collecting cases).

[126] *Id.* at 201-02 (citations omitted).

downloading a dialer program onto users' computers, displaying to the user a disclosure *497 containing the terms and conditions of use, disconnecting the users' phone line from an ISP, reconnecting the phone line to the Internet, and short-stopping calls at web hosts in the United Kingdom. This was an enhanced, not a basic, telecommunications service.

Nor have defendants identified a filed tariff that covered the services they offered. Defendants contend that the filed rate doctrine applies because the calls were nothing more than telephone service and therefore were covered by the AT&T and Sprint tariffs for long-distance calls to Madagascar.[127] According to defendants, neither they nor anyone else changed the form or content of the calls, and consumers were billed only for the carriage of their calls to the Madagascar numbers. This contention falls short. Consumers were not charged merely for the carriage of calls to Madagascar, but for a package of Internet services that included a dialer billing program, the short-stopping of calls outside of Madagascar, and Internet web content. This package was not covered by either the Sprint or AT&T tariffs that defendants rely upon, as those tariffs are for basic international phone calls.[128]

[8] Although the filed rate doctrine did not create a legal obligation to pay for the services, the question remains whether line subscribers were legally obligated to pay based upon the existence of contracts with the defendants. This issue is disposed of easily. As the Court explained previously: "[B]asic contract principles provide that an offer and

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[127] *See* PTO Ex. A ¶ 23.

[128] *See* PX 331 (AT&T Tariff No. 27); PX 299 (Sprint Tariff No. 1). Moreover, as discussed infra p. 498, these tariffs applied to calls that terminated inside the foreign country.

acceptance create a contract only between the offeror and the offeree.... Accordingly, unless the line subscriber is the person who accepts the offer by clicking on the 'I accept' box, there is no contract between the defendants or their clients, on the one hand, and the line subscriber, on the other."[129]

[9] The Court finds that defendants represented to consumers that they were legally obligated to pay for the Internet services provided by defendants' clients. To the extent that the bills were sent to line subscribers who did not access or authorize access to the services, this representation was materially false and a violation of Section 5(a) of the FTC Act.

2. Re-routing calls (Count III)

[10] Count III alleges that defendants violated Section 5(a) by billing consumers for calls to Madagascar, when the charges were for calls that terminated in other countries. Defendants concede that the calls were terminated outside Madagascar. Yet during both the AT&T and Sprint Periods, the bills indicated that the calls were to Madagascar. Reasonable consumers were likely to believe exactly what the misrepresentations stated--that the charges were for phone calls to Madagascar. In addition, these misrepresentations were material. The destination of a phone call in part determines its price and is essential to a consumer's understanding of the basis of the charges being billed. To the extent that defendants made this representation to subscribers who did not agree, or authorize others to agree, to the terms and conditions of the disclosure form, defendants made a materially false representation in violation of Section 5(a).

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[129] *Verity I*, 124 F.Supp.2d at 202.

Defendants contend that no misrepresentation occurred because the calls were completed to the numbers dialed and therefore were covered by the filed tariffs. *498 This argument fails. The bills misrepresented that the location called was Madagascar and, based upon this misrepresentation, sought to extract high prices. Moreover, the tariffs that defendants rely upon cover calls that terminate inside the foreign destination. Sprint Tariff No. 27 states that "the rates apply to all calls which originate in the contiguous United States ... and *terminate in the international locations* ..."[130] Similarly, AT&T Tariff No. 1 states that the rates apply to service "between one or more stations in the Mainland [and other places] and one or more stations ... *in* a foreign country or area."[131] Defendants misrepresented the terminating country and capitalized on the misrepresentation by invoking a high tariff.

The Court finds that defendants violated Section 5(a) by misrepresenting, or causing others to misrepresent, that calls were terminated in Madagascar, when in fact the calls were terminated elsewhere.

3. Disclosure of Costs (Count IV)

[11] The FTC's fourth claim for relief is that defendants failed to disclose in a clear and conspicuous manner the cost of using the Internet services provided by defendants' clients. This claim is without merit. The costs were identified plainly on a disclosure form, no more than two pages in length, that was displayed to users before they accessed the services.[132]

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[130] PX 299 at 2 (emphasis added).

[131] PX 331 at 1 (emphasis added).

[132] See PX 112 at 3.

C. Unfair Practices (Count II)

[12] The FTC's second count alleges that defendants' practice of billing line subscribers who did not use or authorize use of the Internet services offered by the defendants' clients constituted an unfair trade practice in violation of Section 5(a) of the FTC Act. An act or practice is unfair if it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."[133]

The Court infers, and therefore finds, that during the AT&T Period, many line subscribers were charged for services they neither made nor authorized. AT&T and its LECs billed on the basis of ANI information, which identified the subscriber from whose line a call was placed without determining whether that same person made or authorized the call. In addition, AT&T charged back 35 percent of total billings in 2000, when videotext services began, compared to 11 percent of total billing during the prior year. This surge in adjustments indicates that many consumers called to dispute the charges and most likely did so for the same reason as during the Sprint Period-because they neither made nor authorized the calls. In all the circumstances, the Court finds that a significant proportion of the subscribers billed during the AT&T Period neither incurred, nor authorized others to incur, the charges billed to them.

During the Sprint Period, at least 8,651 of the 91,683 consumers who received bills (9 percent) were given adjustments because they denied using or authorizing use of the services. The actual number of subscribers who received bills

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[133] 15 U.S.C. § 45(n).

for calls they did not make or authorize was certainly much higher, as thousands of callers were unable to get through to the call center and many of those who did get through were denied an adjustment, irrespective of whether they had used or authorized use of the services.

*499 The substantial injury to consumers who did not make or authorize the calls is not outweighed by the possible benefit to consumers of having an alternative to disclosing credit card information over the Internet. The thousands of consumer complaints and the large number of charge backs illustrate widespread dissatisfaction.

Defendants contend that there was no unfair trade practice because line subscribers reasonably might have protected themselves against injury by, for example, controlling access to their phone lines, placing an international-call block, locking their computers, or downloading software that would have prevented access to adult websites.[134] Even assuming that such practices would have been effective, the difficulty with defendants' position is that it would require consumers first to suffer an injury and then to find and implement a solution to avoid being injured again. Meanwhile, defendants profit from this injury, as many consumers who are fearful of incurring damage to their credit ratings pay the bills irrespective of whether they used or authorized use of the services of defendants' clients.

The Court finds that defendants' practice of billing line subscribers for Internet services that they neither used, nor authorized use of, constituted an unfair trade practice in violation of Section 5(a) of the FTC Act.

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[134] *See* PTO Ex. A. ¶¶ 29-36.

D. Individual Liability

[13][14][15][16] To establish individual liability for corporate violations of the FTC Act, the FTC must prove that an individual defendant (1) participated directly in the wrongful practices or acts or had authority to control them, and (2) had some knowledge of the wrongful practices or acts.[135] Authority to control may be shown "by active involvement in business affairs and the making of corporate policy, including assuming the duties of a corporate officer."[136] The FTC need not prove intent to defraud in order to establish a violation under the Act or to obtain injunctive or monetary relief against an individual.[137]

Green and Shein participated directly in, and had authority to control, the wrongful practices of the corporate defendants. They concede that they jointly controlled the acts and practices of ACL and Verity up until September 18, 2000 and October 2, 2000, respectively.[138] They were founders, principals, and major shareholders of both companies.

In addition, the FTC has proved that Green and Shein knew of ACL's and Verity's practices. They conceived of the ACL billing system and implemented it by contracting with AT&T, Sprint, GIB, Integretel, and eBillit. During both the AT&T and Sprint Periods, they knew that the phone calls were

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[135] *FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564, 573 (7th Cir.), *cert. denied*, 493 U.S. 954, 110 S.Ct. 366, 107 L.Ed.2d 352 (1989); *accord FTC v. Publ'g Clearing House, Inc.*, 104 F.3d 1168, 1170 (9th Cir.1997); *Five-Star Auto Club*, 97 F.Supp.2d at 535.

[136] *Amy Travel Serv.*, 875 F.2d at 573.

[137] *Id.* at 574; *accord Five-Star Auto Club*, 97 F.Supp.2d at 535.

[138] PTO ¶¶ 22-23.

to access Internet services, that the calls were being short-stopped outside of Madagascar, and that the bills would reflect charges for phone calls to Madagascar, instead of charges to access Internet services.

Green and Shein therefore are individually liable for ACL's and Verity's violations of the FTC Act.

III

The FTC seeks injunctive relief and a refund of monies paid by consumers and a disgorgement of funds reaped by defendants through their violations of the Act.

A. Injunctive Relief

[17][18] The FTC asks the Court to enjoin defendants Verity, Green, and Shein from engaging in any capacity in the provision of any audiotext or videotext services to U.S. consumers. Although injunctive relief should be tailored to address specific harms and not impose unnecessary burdens on lawful activity,[139] courts may enjoin otherwise legitimate conduct in order to prevent future violations.[140]

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[139] *See, e.g., Soc'y for Good Will to Retarded Children, Inc. v. Cuomo*, 737 F.2d 1239, 1251 (2d Cir.1984) (citing *Hartford-Empire Co. v. United States*, 323 U.S. 386, 409-10, 65 S.Ct. 373, 89 L.Ed. 322 (1945)); *Peregrine Myanmar Ltd. v. Segal*, 89 F.3d 41, 50 (2d Cir.1996) (citing *Waldman Publ'g Corp. v. Landoll, Inc.*, 43 F.3d 775, 785 (2d Cir.1994)).

[140] *See, e.g., Five-Star Auto Club*, 97 F.Supp.2d at 536 (defendants permanently enjoined from participating in any multi-level marketing); *FTC v. Micom*, No. 96-0472(SS), 1997 WL 226232 (S.D.N.Y. Mar. 12, 1997) (defendants permanently prohibited from engaging in business of preparing or filing government licenses).

A broad permanent injunction is warranted in the circumstances. First, defendants' fraud was calculated and substantial. Green and Shein orchestrated an elaborate scheme to cause phone bills to reflect charges for long-distance phone calls to Madagascar, when in reality those charges were for videotext services and the calls were terminated elsewhere. They preyed upon consumers' well-founded understanding that all charges on a telephone bill must be paid, regardless of whether they were authorized. Verity and ACL were the corporate vehicles they used to perpetrate the fraud.

In addition, Green and Shein have failed to show remorse for the consumer harm they inflicted. Instead, they willfully have violated this Court's orders and showed an intention to put assets taken from U.S. consumers out of the reach of U.S. authorities. The preliminary injunction that this Court entered required, inter alia, that defendants produce to the FTC financial statements that were needed in order to ensure the availability of funds necessary to remedy the alleged harm.[141] Green and Shein deliberately and wilfully defied the Court's order, were held in contempt, and appear to remain at large.[142] As Green and Shein are foreign business people who directed monies to be paid to overseas accounts and later refused to comply with an order to make those monies available for consumer redress,[143] any repeat of their past conduct would

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[141] *See Verity II*, 140 F.Supp.2d at 314-15.

[142] *Id.* at 317 ("By withholding financial statements, Green and Shein quite deliberately and willfully are attempting to thwart efforts by the FTC to ensure that funds are available to remedy the harm they allegedly have done."). Defendant Verity belatedly complied with the FTC's requests and was not held in contempt. *Id.* at 315.

[143] PX 154 ¶ 4; PX 155 ¶ 4.

again result in further consumer injury that is virtually irreparable.

These circumstances lead the Court to conclude that a broad permanent injunction is necessary to prevent future violations. The Court therefore will enter an order prohibiting defendants Verity, Green, and Shein from participating in any capacity in the offering of audiotext or videotext services to U.S. consumers.

[19] The FTC seeks also restrictions upon ACL's billing practices similar to those contained in the preliminary injunction. Such restrictions are reasonable *501 measures to prevent ACL from committing future violations similar to those in which it previously engaged. Accordingly, ACL will be enjoined from engaging in ANI-based billing of any line subscriber unless (1) the line subscriber provides express verifiable authorization agreeing to purchase and be billed for such services, or (2) the bill conspicuously contains an express statement that the line subscriber is not obliged to pay the bill unless he or she personally agreed or authorized another to agree to pay for the services for which the bill is rendered and provides a convenient method by which a line subscriber who claims not to have done so may have the bill canceled. Additionally, ACL shall be enjoined from (1) misrepresenting that line subscribers are legally obligated to pay for Internet services obtained using the ACL billing system irrespective of whether they used or authorized use of those services, and (2) misrepresenting on bills the true nature of the charges for which consumers are being billed.

B. Monetary Relief

[20] The FTC seeks restitution, consumer redress, and disgorgement of funds gained by defendants' deceptive and unfair trade practices. Section 13(b) of the Act provides that, "in proper cases the Commission may seek, and after proper

proof, the court may issue, a permanent injunction."[144] Although this section does not expressly authorize courts to provide monetary relief, "courts have held repeatedly that the district court may employ the full range of equitable remedies as incident to its power to grant injunctive relief sought by the FTC under Section 13(b)."[145] The Court therefore has broad equitable authority to grant "any ancillary relief necessary to accomplish complete justice" under this section.[146]

1. The AT&T Period

[21] The appropriate monetary relief is the full amount lost by consumers.[147] The FTC seeks disgorgement from defendants in the amount of $16 million for payments made during the AT&T Period. Defendants concede that they do not know how much of the estimated $17.8 million paid during the AT&T Period was for videotext as opposed to audiotext. They contend, without explanation, that the amount paid may be attributed equally to videotext and audiotext. However, ACL has attributed the increase in 2000 billings to ACL's successful commercialization of its dialer billing system. The FTC contends, and the Court finds, that a reasonable approximation of the amount billed for videotext in 2000 is the difference

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144 15 U.S.C. § 53(b) (2004).

145 *Verity I*, 124 F.Supp.2d at 205-06 (collecting cases).

146 *Id.* at 206 (quoting *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1113 (9th Cir.1982)).

147 *E.g.*, *FTC v. Febre*, 128 F.3d 530, 535-36 (7th Cir.1997); *FTC v. Medicor, LLC*, 217 F.Supp.2d 1048, 1058 (C.D.Cal.2002); *Five-Star Auto Club, Inc.*, 97 F.Supp.2d at 534.

between estimated payments in 2000 and estimated payments in 1999, [illegible] 6.3 million.[148]

The next question is the amount, if any, that should be subtracted for subscribers who actually used or authorized use of the Internet services for which they paid. The FTC concedes that some consumers who received bills actually used or authorized use of the services. The difficulty, however, is that neither party knows how many. Yet, defendants' own conduct has made it impossible to exclude these subscribers. *502 Defendants employed an ANI-based billing system that did not ascertain whether subscribers had made or authorized use of the services. Where defendants' own misconduct prevents an exact determination of the amount of consumer loss, "[t]he risk of uncertainty should fall on the wrongdoer whose illegal conduct created the uncertainty."[149] Defendants ACL, Green and Shein therefore are liable for consumer redress in the amount of $16.3 million.[150]

2. The Sprint Period

Turning to the Sprint Period, the FTC asserts that the appropriate monetary relief is the entire $1,616,678 million paid during that period. During the Sprint Period, all of the

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[148] *See Five-Star Auto Club*, 97 F.Supp.2d at 534 ("Plaintiff has the burden of showing that its calculations reasonably approximate the amount of consumers' net loss.").

[149] *Febre*, 128 F.3d at 535 (quoting *SEC v. First City Fin. Corp.*, Ltd., 890 F.2d 1215, 1232 (D.C.Cir.1989)); *accord Five-Star Auto Club*, 97 F.Supp.2d at 534.

[150] The FTC's proposed order seeks monetary relief during the AT&T Period from all of the ACL defendants, including Verity. However, the FTC has not proven Verity's involvement during the AT&T Period. Therefore, any relief with respect to the AT&T Period is limited to defendants ACL, Green and Shein.

calls were for Internet services. Once again, defendants' own conduct makes it impossible to determine the amount paid by line subscribers who used or authorized use of the services. Accordingly, defendants ACL, Verity, Green and Shein are liable for monetary relief in the amount of $1.6 million for consumer injury caused during the Sprint Period.

C. Other Relief

The FTC further asks the Court to impose upon defendants various reporting, monitoring, and record-keeping requirements. The Court will enter an order incorporating such relief only to the extent it is necessary to prevent future illegal conduct and not unduly burdensome.

IV

For the foregoing reasons, plaintiff shall have judgment against defendants ACL, Green and Shein, jointly and severally, in the amount of $16,300,000. In addition, plaintiff shall have judgment against defendants ACL, Verity, Green and Shein, jointly and severally, as follows: (a) awarding to plaintiff the sum of $1,616,678, and (b) permanently enjoining defendants in accordance with this opinion. Settle judgment on three days notice. The preliminary injunction will remain in effect until the permanent injunction is entered.

Plaintiff's motion to admit additional consumer declarations and defendants' motion to admit the declaration of Robert S. Laughlin are denied as moot.

SO ORDERED.

APPENDIX C

UNITED STATES DISTRICT COURT,
S.D. NEW YORK.

No. 00 CIV.7422(LAK).

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

VERITY INTERNATIONAL, LTD., et al.,

Defendants.

April 1, 2002

MEMORANDUM OPINION

KAPLAN, District Judge.

This case concerns the provision of billing and other services to adult content Internet web sites. It has been the subject of several previous opinions and orders, [1] familiarity with which is assumed. The matter now is before the Court on the ***273** FTC's motion to extend the existing preliminary injunction to a recently joined defendant, Automatic Communications Limited ("ACL"), and defendants' motion for judgment on the pleadings dismissing the complaint. In view of certain issues raised by ACL, the Court has the benefit of an

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[1] *See FTC v. Verity Int'l, Ltd.*, 124 F.Supp.2d 193 (S.D.N.Y.2000) (*"Verity I"*); *see also FTC v. Verity Int'l, Ltd.*, No. 00 Civ. 7422(LAK), 2001 WL 504849 (S.D.N.Y. May 14, 2001); *FTC v. Verity Int'l, Ltd.*, 140 F.Supp.2d 313 (S.D.N.Y.2001); *FTC v. Verity Int'l, Ltd.*, No. 00 Civ. 7422(LAK), 2000 WL 1805688 (S.D.N.Y. Dec. 8, 2000).

amicus brief filed on behalf of the Federal Communications Commission ("FCC").

I.

ACL is an Australian company which, together with affiliates, has operated an Internet billing service for some time. Although there have been changes over time, the essence of the service has remained the same through the relevant period.

Defendants made available to their clients software that presented a computer user who accessed a client Internet web site[2] with a series of screens purportedly setting forth the terms and conditions of use of the site. If the user clicked a box stating "I agree," a dialer computer program supplied by defendants automatically downloaded to the user's computer, disconnected the user's modem from its ISP, and placed a call to a Madagascar telephone number assigned by Madagascar to ACL. ACL then "stopped" the call in the United Kingdom and reconnected it to the client web site, enabling the user to view the contents of the site. The subscriber of the line from which the call to the Madagascar number had been placed–who may or may not have been the person or entity that placed the call–then was identified through automatic number identification ("ANI") and billed for a purported international telephone call to Madagascar, although the charge in fact was that imposed for access to the contents of the site.[3] Defendants then divided the proceeds of the bills with the client web site operators in accordance with their contractual arrangements.

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[2] Access typically involved use of the consumer's computer and modem, a telephone line, and an Internet service provider ("ISP"). *See Verity I*, 124 F.Supp.2d at 195.

[3] *See id.* at 195.

Beginning in January 1999, ACL had agreements with AT&T and, briefly, Sprint to handle the traffic and bill customers. In the summer of 2000, however, it chose to have the billing handled by its affiliate, Verity International, Ltd. ("Verity"). The switch over to Verity was a disaster,[4] and it led to the commencement of this action against, insofar as is relevant here, Verity and its principals, Robert Green and Marilyn Shein. The essence of the FTC's position is that (1) defendants' insistence that line subscribers are legally obligated to pay for access to these web sites where the line subscribers neither used them nor authorized such use, and (2) billing of calls "stopped" in the United Kingdom as calls to Madagascar both violated Section 5(a) of the Federal Trade Commission Act (the "FTC Act").[5]

On January 4, 2001, the Court granted the Commission's motion for a preliminary injunction and an asset freeze.[6] The complaint, however, was ambiguous as to whether it sought relief in respect of the period prior to Verity's commencement of billing. Accordingly, relief was limited to the Verity period.

***274** In March 2001, the FTC filed a second amended complaint, adding ACL as a defendant and expanded its claims to the period in which billing was done by AT&T and Sprint on behalf of ACL. The Commission then moved to extend the preliminary injunction to ACL, and defendants made related cross-motions. These motions have been resolved in all respects but one. The Court reserved the issue of the extension

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[4] *Id.* at 196-97.

[5] 15 U.S.C. § 45(a).

[6] Green and Shein have been held in civil contempt for violation of the injunction and apparently remain fugitives.

of the preliminary injunction to ACL[7] and conducted an evidentiary hearing on that subject on June 5, 2001.

II.

Defendants move for judgment on the pleadings on four grounds. First, they maintain that ACL is a common carrier and thus outside the FTC's jurisdiction.[8] Next, they contend that the filed rate doctrine precludes line subscribers from disputing the charges at issue because they were imposed in accordance with tariffs filed with the FCC. Third, defendants argue that the FCC has primary jurisdiction over this case or, at least, certain issues it presents. Finally, they assert that the complaint does not plead fraud with the particularity required by Rule 9(b).

A. FTC Act Jurisdiction

[1] The FTC Act explicitly excludes from its coverage "common carriers subject to the Acts to regulate commerce."[9] It defines the Communications Act of 1934 ("Communications Act") as such a statute.[10] Some time in 1999, ACL applied to

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[7] *See* Order, May 14, 2001, at 5.

[8] This argument first was raised in ACL's reply memorandum and, by rights, should not be considered. *See, e.g., Andrews v. Emerald Green Pension Fund,* No. 98-436-P-H, 2000 WL 761672, at *5 n. 6 (D.Me. Mar. 29, 2000); *United States ex rel Coleman v. Ryan,* No. 97 C 2067, 1998 WL 292988, at * 14 n. 8 (N.D.Ill. May 28, 1998), *aff'd,* 196 F.3d 793 (7th Cir.1999), *cert. denied,* 531 U.S. 848, 121 S.Ct. 120, 148 L.Ed.2d 75 (2000); *Silver v. Countrywide Realty, Inc.,* 39 F.R.D. 596, 598-99 (S.D.N.Y.1966). Inasmuch as the issue is likely to recur, the Court instead has considered the FTC's supplemental submission in response to the belated contention and will address it now.

[9] 15 U.S.C. § 45(a)(2).

[10] *Id.* § 44.

the FCC for authority under Section 214 of the Communications Act[11] to become a facilities- or resale-based international common carrier. It appears that the application was granted and a tariff filed shortly thereafter.[12] ACL contends that its activities therefore are beyond the reach of the FTC.

ACL's argument presupposes that once the FCC licenses an entity as a common carrier, it is a common carrier for all purposes and thus entirely beyond the reach of the FTC. But that premise is fundamentally erroneous. An entity that is a common carrier may engage in a broad range of activities, some integral to its functions as a common carrier and some entirely extraneous to them. Even where Congress commits regulation of common carrier activities to a particular agency, it would make little sense to exempt a carrier's extraneous activities from laws of general application affecting the broad sweep of American business. In fact, ACL has conceded that the Communications Act, as amended, specifically states that "a telecommunications carrier shall be treated as a common carrier under this chapter only to the extent that it is engaged in providing telecommunications services."[13] Thus, ***275** the better considered authorities, as well as the FCC, agree that whether an entity is a common carrier for regulatory purposes depends on the particular activity at issue.[14] In other words, an

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[11] 47 U.S.C. § 214.

[12] *See* Eilander Reply Decl. Exs. 1 (notice of filing of application), 2 (ACL tariff).

[13] ACL Mem. 16 (quoting 47 U.S.C. § 153(44)).

[14] *See, e.g., Computer & Comm. Ind. Ass'n v. FCC,* 693 F.2d 198, 209 n. 59 (D.C.Cir.1982) (using term "common carrier" to "indicate not an entity but rather an activity as to which an entity is a common carrier"), *cert. denied,* 461 U.S. 938, 103 S.Ct. 2109, 77 L.Ed.2d 313 (1983); *Nat'l Ass'n of Regulatory Util. Comm'rs v. FCC,* 533 F.2d 601, 608 (D.C.Cir.1976)

entity may be a common carrier within the meaning of the Communications Act for some purposes and not for others.[15]

To be sure, *FTC v. Miller*,[16] upon which ACL relies heavily, indicates otherwise. The Seventh Circuit there quashed FTC subpoenas served on a mobile home transporting company in an investigation of alleged unfair trade practices on the ground that the respondent operated under a certificate of convenience and necessity issued by the Interstate Commerce Commission and therefore was a common carrier exempt from FTC scrutiny under Section 5(a)(2) of the FTC Act.[17] Indeed, ACL goes on to point out that language in *Miller* to the effect that the Section 5(a)(2) exemption depends on the status of the party under scrutiny rather than its conduct was quoted by the Second Circuit in *Official Airline Guides, Inc. v. FTC* ("*OAG*")[18] with apparent approval. But neither *Miller* nor *OAG* is persuasive here.

As far as *Miller* is concerned, it is inconsistent with common sense proposition that the carrier exemption to the FTC Act

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("*Naruc II*"); *cf.* 47 U.S.C. § 153(10) (defining "common carrier" as any person "engaged as" a common carrier).

[15] *S.W. Bell Tel. Co. v. FCC*, 19 F.3d 1475, 1480 (D.C.Cir.1994); *Naruc II*, 533 F.2d at 608; *In re Audio Comm., Inc.*, 1993 WL 525815, 8 FCCR 8697, at ¶ 12 (1993) ("The [FCC] has clearly established that a single firm that is a common carrier in some roles need not be a common carrier in other roles."); *see also FCC v. Midwest Video Corp.*, 440 U.S. 689, 701 n. 9, 99 S.Ct. 1435, 59 L.Ed.2d 692 (1979) ("A cable system may operate as a common carrier with respect to a portion of its services only.").

[16] 549 F.2d 452 (7th Cir.1977).

[17] 15 U.S.C. § 45(a)(2).

[18] 630 F.2d 920 (2d Cir.1980), *cert. denied*, 450 U.S. 917, 101 S.Ct. 1362, 67 L.Ed.2d 343 (1981).

should be construed no more broadly than its purpose–to avoid interfering with the regulation of carriers by agencies to which their regulation is committed. There was no inherent inconsistency between ICC regulation of, for example, entry into and rates charged by interstate trucking companies and FTC investigation of their allegedly unfair trade practices. Hence, this Court, agrees with other courts and the FCC, which hold that the term "common carrier . . . indicates not an entity but rather an activity as to which an entity is a common carrier."[19] Indeed, it must be borne in mind that *Miller* concerned the Interstate Commerce rather than the Communications Act. The Communications Act, as amended by the Telecommunications Act of 1996, specifically states that "a telecommunications carrier shall be treated as a common carrier under this chapter only to the extent that it is engaged in providing telecommunications services,"[20] implying that an entity can be treated as a common carrier for certain activities and not as a common carrier for non-telecommunications activities.

***276** Nor is *OAG* of greater help to ACL. The Second Circuit there held that a company that published flight schedules was not exempt from the FTC Act under the exemption for air carriers equivalent to that for common carriers. Although some of the language suggests that status is more important than activity,[21] the case itself addresses whether an entity that is not a carrier falls into the exception when its

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[19] *See Naruc II*, 533 F.2d 601, 608 (D.C.Cir.1976); *In re Audio Communications, Inc.*, 8 F.C.C.R. 8697, ¶ 12 (1993) ("The [FCC] has clearly established that a single firm that is a common carrier in some roles need not be a common carrier in other roles.").

[20] 47 U.S.C. § 153(44).

[21] *See Official Airline Guides*, 630 F.2d at 923 (quoting *Miller*, 549 F.2d at 455).

activities are subject to regulation under the relevant act. In contrast, here the question is whether the activities–even those not regulated by the Communications Act–of an entity that is licensed as a carrier are beyond the scope of the FTC Act. [22] Moreover, underlying the reasoning in *Official Airline Guides* is a comparison of the "broad mandate given to the [Federal Trade] Commission to enforce section 5" with "the narrow exemption from the Commission's jurisdiction."[23] In these circumstances, these policies support a holding that ACL is not exempt.

This is precisely the conclusion advocated by the FCC, the agency charged with administration of the Communications Act, as *amicus*.[24] While not entitled to full *Chevron* deference, the FCC's informal views on this subject certainly are entitled to some deference.[25] It points out that FCC regulations define a communication common carrier as "any person engaged in

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[22] The other case on which defendants rely has the same limitation. *See FTC v. Saja*, No. Civ-97-0666-PHX-SMM, 1997 WL 703399, at *1 (D.Ariz. Oct. 7, 1997) (fundraising for not-for-profit organizations does not make an entity a nonprofit).

[23] *Official Airline Guides*, 630 F.2d at 923.

[24] Brief of Federal Communications Commission as *Amicus Curiae*, at 1-3, *FTC v. Verity Int'l, Ltd.*, 00 CV 7422(LAK) ("FCC *Amicus* Brief").

[25] *See, e.g., United States v. Mead Corp.*, 533 U.S. 218, 233-35, 121 S.Ct. 2164, 150 L.Ed.2d 292 (2001); *TeamBank, N.A. v. McClure*, 279 F.3d 614, 618-19 (8th Cir.2002); *Matz v. Household Int'l Tax Reduction Inv. Plan*, 265 F.3d 572, 573-74 (7th Cir.2001), *cert. denied*, 535 U.S. 954, 122 S.Ct. 1357, 152 L.Ed.2d 353 (2002); *Hall v. United States EPA*, 273 F.3d 1146, 1155-56 (9th Cir.2001); *Commonwealth Edison Co. v. Vega*, 174 F.3d 870, 875 (7th Cir.), *cert. denied*, 528 U.S. 873, 120 S.Ct. 176, 145 L.Ed.2d 149 (1999).

rendering communication service for hire to the public."[26] The regulation has been construed as establishing a two prong test determinative of common carrier status. First, the "primary *sine qua non* . . . is a quasi-public character, which arises out of the undertaking to carry for all people indifferently."[27] The second is "that the system be such that customers 'transmit intelligence of their own design and choosing.' "[28]

[2] ACL has described its business as being comprised of three activities: (1) obtaining the rights to certain telephone numbers in foreign countries, (2) licensing the use of those numbers to companies that market billing software to web site operators, and (3) agreeing with long distance carriers to terminate calls from the carriers' home countries to the numbers in foreign countries in respect of which ACL has acquired rights.[29]

[3] These activities do not satisfy the test. As the FCC has said, "[t]he ultimate ***277** test is the nature of the offering to the public."[30] ACL does not claim to have held itself out to

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[26] 47 C.F.R. § 21.2 (2001).

[27] *Naruc II,* 533 F.2d at 608 (internal quotation marks omitted); *accord, S.W. Bell Tel. Co.,* 19 F.3d at 1480.

[28] *Naruc II,* 533 F.2d at 609 (quoting *Indus. Radiolocation Serv.,* 1966 WL 13821, 5 F.C.C.R.2d 197, 202 (1966)); *accord S.W. Bell Tel. Co.,* 19 F.3d at 1480.

[29] Blanchard Reply Decl., Apr. 24, 2001, ¶ 3.

[30] *REGULATORY POLICIES CONCERNING RESALE AND SHARED USE OF COMMON CARRIER SERVICES AND FACILITIES ("Resale and Shared Use Order"),* 1976 WL 31603, 60 F.C.C.2d 261, ¶ 101 (1976), *modified by* 60 F.C.C.2d 588 (1976), *modified by* 61 F.C.C.2d 70 (1976), *aff'd on reconsideration,* 62 F.C.C.2d 588 (1977), *aff'd sub nom. AT&T v. FCC,* 572 F.2d 17 (2d Cir.), *cert. denied,* 439 U.S. 875, 99 S.Ct. 213, 58 L.Ed.2d 190 (1978).

the public as an indifferent provider of telecommunications services. It was AT&T, and later Sprint, that provided long distance services to the public as common carriers. ACL did not set the rates, terms or conditions for those services. Nor did it physically do the billing.[31] Indeed, to whatever extent that ACL might have provided transmission services on a common carrier basis, it did so as a terminating carrier as agent for Telecom Malagasy. To that extent, it stood in the shoes of Telecom Malagasy and thus was a foreign terminating carrier rather than a common carrier subject to the FCC's jurisdiction.[32]

[4] ACL's contention that it is a reseller and therefore a common carrier also is without merit. As the FCC points out, resale is "an activity wherein one entity subscribes to the communications services and facilities of another entity and then reoffers communications service and facilities to the public (with or without 'adding value') for profit."[33] The only thing ACL resold was the right to terminate calls to certain

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[31] *Cf. IN RE PHILIPPINE LONG DISTANCE TEL. CO. v. USA LINK, L.P.*, 1997 WL 458228, 12 F.C.C.R. 12,010, at ¶ ¶ 17-19 (1997).

[32] *See* 47 U.S.C. § 152(a) (Communications Act applies "to all interstate and foreign communication by wire or radio ... which originates and/or is received within the United States"); *Cable & Wireless P.L.C. v. FCC*, 166 F.3d 1224, 1229-30 (D.C.Cir.1999) (noting that FCC "claims no authority to directly regulate foreign carriers" and holding that order did not violate Communications Act because it did not regulate foreign carriers or foreign telecommunications).

[33] *RESALE AND SHARED USE ORDER*, 60 F.C.C.2d at ----, at ¶ 17; *see also National Communications Ass'n, Inc. v. AT&T*, 46 F.3d 220, 221 (2d Cir.1995) (defining reseller as "one who engages in the business of purchasing long-distance telecommunications services at large-volume rates from a supplier, such as AT&T, and resells those services to others whose volume of use individually would not qualify them to purchase directly from the supplier").

Madagascar numbers.[34] Even this it did not sell to the general public–only to a limited group of providers to whom ACL licensed the Madagascar numbers it licensed from Telecom Malagasy.

For all of the foregoing reasons, there is no basis for concluding that the ACL activities at issue in this case are common carrier activities within the meaning of the Communications Act.

B. Primary Jurisdiction

[5][[6] The doctrine of primary jurisdiction allows a federal court to stay or dismiss a case that involves "technical and intricate questions of fact and policy that Congress has assigned to a specific agency,"[35] here potentially the FCC. The doctrine "applies where a claim is originally cognizable in the courts, but enforcement of the claim requires, or is materially aided by, the [agency's] resolution of threshold issues." [36]This circuit has called the scope ***278** of the doctrine "relatively narrow,"[37] and courts typically have deferred to agencies in

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[34] *See* Tr., June 5, 2002, 135 ("ACL basically was a seller of the 2617 termination"); Blanchard Reply Decl. Ex. 3 (co-carrier interconnection agreement, not contract to purchase bulk AT&T services).

[35] *Nat'l Communications Ass'n, Inc. v. AT&T*, 46 F.3d at 223.

[36] *Golden Hill Paugussett Tribe of Indians v. Weicker*, 39 F.3d 51, 58-59 (2d Cir.1994).

[37] *Goya Foods, Inc. v. Tropicana Prods., Inc.*, 846 F.2d 848, 851 (2d Cir.1988).

actions that involved the validity of a rate or practice related to a tariff filed with an agency[38] or technical issues of fact.[39]

[7] ACL argues that the Court should defer to the FCC in part because the case raises issues including whether ACL is a common carrier and whether the filed rate doctrine applies to the activities here at issue. But resolution of such questions by courts is routine.[40] The more interesting issue is whether ANI billing for videotext is a deceptive trade practice in these circumstances.

The threshold question is whether the FCC has authority over this issue.[41] The Communications Act gives the FCC authority over "all interstate and foreign communication by

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[38] *E.g., Tex. & P. Ry. Co. v. Am. Tie & Timber Co.*, 234 U.S. 138, 146, 34 S.Ct. 885, 58 L.Ed. 1255 (1914) (whether railroad ties could be shipped under a "lumber" tariff should be decided by the ICC rather than the court); *Danna v. Air France*, 463 F.2d 407, 409-11 (2d Cir.1972) (claim under the Federal Aviation Act that challenged the reasonableness and discriminatory effect of an airline tariff was a question for the Civil Aeronautics Board).

[39] *E.g., Johnson v. Nyack Hosp.*, 964 F.2d 116, 122 (2d Cir.1992) (New York Public Health Council should decide whether there was a sound medical reason for hospital to terminate physician's privileges to perform thoracic and vascular surgery).

[40] *See, e.g., Nat'l Ass'n of Regulatory Util. Comm'rs v. FCC*, 525 F.2d 630, 642 (D.C.Cir.) ("*Naruc I* ") (defining common carrier), *cert. denied*, 425 U.S. 992, 96 S.Ct. 2203, 48 L.Ed.2d 816 (1976); *Naruc II*, 533 F.2d at 608 (same); *Marcus v. AT&T*, 138 F.3d 46, 58-59 (2d Cir.1998) (applying the filed rate doctrine).

[41] *E.g., Fulton Cogeneration Assocs. v. Niagara Mohawk Power Corp.*, 84 F.3d 91, 97 (2d Cir.1996) (as a threshold matter, court applying primary jurisdiction reasoning must determine that the agency has jurisdiction over the issue).

wire or radio."[42] The agency has jurisdiction over common carriers and ancillary jurisdiction that permits it to take what actions are necessary to exercise its functions.[43] In other words, regardless of whether ACL is a common carrier, it is fairly clear that the issue is within the FCC's jurisdiction.[44] AT&T and Sprint are certainly common carriers, and ANI billing is a concern for telecommunications services. Moreover, although the FCC has left "enhanced" or "information" services essentially unregulated, it retains jurisdiction over them.[45]

[8] That the FCC appropriately might reach the issues here does not necessarily ***279** mean that this Court should defer to it. Primary jurisdiction analysis is not an exact science, but courts in this circuit generally have considered the following factors: whether an issue is within the conventional experience of judges or instead involves technical or policy

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[42] 47 U.S.C. § 152(a).

[43] *Id.* § 208(a) (FCC has jurisdiction over "anything done or omitted to be done by any common carrier" subject to the Communications Act); *id.* § 154(i) ("The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions."); *see* PETER W. HUBER ET AL., FEDERAL TELECOMMUNICATIONS LAW § 3.3.2, at 221 (2d ed. 1999 & Supp.2001) (explaining that FCC's jurisdiction is not limited to any particular technology because of its "ancillary jurisdiction," which is rooted in Section 154(i) of the Communications Act).

[44] *Cf. LO/AD Communications, B.V.I., Ltd. v. MCI WorldCom,* No. 00 Civ. 3594(JGK), 2001 WL 64741, at *5 (S.D.N.Y. Jan. 24, 2001) (holding that the regulation of audiotext services is within the FCC's authority).

[45] *See In re Second Computer Inquiry,* 77 F.C.C.2d 384, 432, ¶ 124 (1980), *reconsidered by* 84 F.C.C.2d 50 (1980), *further reconsidered by* 88 F.C.C.2d 512 (1981), *aff'd sub nom. Computer & Communications Indus. Ass'n v. FCC,* 693 F.2d 198 (D.C.Cir.1982), *cert. denied,* 461 U.S. 938, 103 S.Ct. 2109, 77 L.Ed.2d 313 (1983).

determinations within the agency's particular field of expertise, whether the issue is particularly within the agency's discretion, whether there is a substantial danger of inconsistent rulings and whether prior application to the agency has been made. Finally, courts weigh the advantages of applying the doctrine against the potential costs of complications and delay resulting from the administrative proceedings.[46]

These factors weigh against staying or dismissing this action. First, it does not involve a technical determination within the FCC's particular domain in that there are many precedents on application of the "enhanced" versus "basic" or the "information" versus "telecommunications" divide. Even when the interpretation of a tariff is involved, if an agency has already construed the tariff or "clarified the factors underlying it," a court rather than the agency appropriately might address the issue.[47]

Second, courts usually have described an issue as within an agency's particular discretion when it involves evaluating the reasonableness of a tariff or related practice.[48] Here there is no comparable exercise of discretion.

Third, the danger of inconsistent rulings is not substantial in that any decision will be fact-dependant and will not concern ANI billing in general but rather will be limited to ANI billing for videotext with bills similar to those here.

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[46] *See Nat'l Communications Ass'n*, 46 F.3d at 222-23.

[47] *United States v. W. Pac. R. Co.*, 352 U.S. 59, 69, 77 S.Ct. 161, 1 L.Ed.2d 126 (1956); *see also Duffy v. BMC Indus.*, 938 F.2d 353, 357 (2d Cir.1991) (calling "unexceptional" the proposition that "a court need not refer a tariff construction issue to the Commission if the Commission has previously construed the particular tariff").

[48] *E.g., Danna v. Air France*, 463 F.2d 407, 410, 412 (2d Cir.1972).

Finally, a deferral to the FCC would cause unnecessary delay.

The FCC, as *amicus,* agrees. It does not believe that its special expertise would be helpful, as the issue here is whether ACL's role in a billing scheme was a deceptive trade practice within the meaning of the FTC Act.

C. Filed Rate Doctrine

[9] Whether the filed rate doctrine applies is at the heart of defendants' potential liability and is addressed in detail in *Verity I.*[49] Essentially, defendants argue that the services at issue are telecommunications services rather than information services and that the filed rate doctrine therefore applies, making the representation that line subscribers were legally obligated to pay their bills accurate rather than misleading or deceptive.

Defendants add little new beyond citation to the FCC's statement in *IN RE FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE,*[50] which held that information service providers would not be treated as common carriers[51] but that an entity is deemed to provide telecommunications when it "provides a transparent ***280** transmission path [that] does not 'change . . . the form and content' of the information."[52] Defendants argue that ACL merely provided a transparent path for information and therefore offered telecommunications

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[49] *See Verity I,* 124 F.Supp.2d at 200-02.

[50] 13 F.C.C.R. 11,501 (1998), *available at,* 1998 WL 166178.

[51] *Id.* ¶ 60 (making "clear that offerings by non-facilities-based providers combining communications and computing components should always be deemed enhanced").

[52] *Id.* ¶ 41 (alteration in original).

service. The difficulty is that ACL is analogous neither to an ISP nor to a facilities-based common carrier like AT&T. The FCC's statement reaffirmed the mutually exclusive nature of telecommunications and information services.[53] It was concerned with identifying which type of service was provided by ISPs and common carriers like AT&T that connect with ISPs and/or provide both lines and information services.

Taking the factual allegations in the FTC's complaint as true, as the Court must for this motion, ACL did not merely provide a transparent transmission path. The FTC alleges that it supervised dialer disclosures, arranged to stop calls in London, and connected the consumers' modems to the Internet, which would mean it was providing some combination of computing and communications services, placing it in the category of enhanced services. Accordingly, defendants have not shown that plaintiff can prove no set of facts in support of its claim that would entitle it to relief.

Once again, the FCC has supported the FTC's position. It points out that the issue here is not the validity, direct or indirect, of the tariffs applied and that ACL does not appear to be a common carrier. In consequence, it views the filed rate doctrine as affording ACL no shield against the FTC's deceptive trade practices charge.[54]

In a related argument, advanced in a footnote, defendants request dismissal for lack of subject matter jurisdiction.[55] They reason that, because the filed rate doctrine applies, those who used the service did not suffer any injury and that "their surrogate" the FTC therefore did not suffer an injury. Thus,

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[53] *See id.* ¶ ¶ 13, 39, 57.

[54] FCC *Amicus* Brief, at 6.

[55] *See* ACL Mem. 15 n. 26.

defendants argue, the FTC lacks standing and the Court lacks subject matter jurisdiction.

[10][11] Dismissal on these grounds would be inappropriate for several reasons, including the fact that the plaintiff is the FTC rather than a private plaintiff and a decision on standing would merge with decision on the merits. But they need not be considered in detail as "[t]he determination of whether Article III standing exists . . . must comport with the 'manner and degree of evidence required at the successive stages of the litigation.'"[56] On a motion for judgment on the pleadings, the facts averred by the plaintiff must be taken as true for purposes of the standing inquiry. Given this standard, the FTC clearly has alleged sufficient injury.

D. Rule 9(b)

Defendants' Rule 9(b) argument–that the FTC is making a claim of fraud and that fraud must be pled with particularity–is without merit.[57] The second amended complaint sufficiently details who, what, when, where and how, identifying ACL and describing its relationship to the other defendants, describing the billing system, and specifying the time period.[58]

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[56] *E.g., Lerman v. Bd. of Elections,* 232 F.3d 135, 142 (2d Cir.2000) (quoting *Lujan v. Defenders of Wildlife,* 504 U.S. 555, 561, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992)).

[57] Defendants raise this argument in the context of both motions addressed in this opinion. For the reasons here described, it is without merit in either context.

[58] Second Am. Compl. ¶ ¶ 6, 9-10, 13-18, 22.

*281 *III. Extension of the Preliminary Injunction to ACL*

[12] The second motion before the Court is to extend the preliminary injunction to ACL. The FTC may obtain a preliminary injunction "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest."[59] The standard differs from that applicable to private applicants for such relief in that the FTC does not have to show irreparable harm,[60] but the Court must (1) determine that the FTC has a fair and tenable chance of ultimate success on the merits[61] and (2) consider the equities.[62]

[13] ACL's principal argument against the FTC's application is simplicity itself: All the billing was done by AT&T. ACL had nothing to do with it. "Any potential liability for misrepresentations included on AT&T bills lie [*sic*] solely with AT&T."[63] With all due respect, the likelihood of ACL avoiding

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[59] 15 U.S.C. § 53(b).

[60] H.R. CONF. REP. NO. 93-624, at 18 (1973), *reprinted in* 1973 U.S.C.C.A.N. 2523, 2533 ("The intent is to maintain the statutory or 'public interest' standard which is now applicable, and not to impose the traditional 'equity' standard of irreparable damage, probability of success on the merits, and that the balance of equities favors the petitioner."); *FTC v. Affordable Media,* 179 F.3d 1228, 1233 (9th Cir.1999).

[61] *See United States v. Sun & Sand Imps., Ltd.,* 725 F.2d 184, 188 (2d Cir.1984); *FTC v. Lancaster Colony Corp.,* 434 F.Supp. 1088, 1090-91 (S.D.N.Y.1977).

[62] *See Verity I,* 124 F.Supp.2d at 199-200; *Lancaster Colony Corp.,* 434 F.Supp. at 1096 ("The equities to be weighed ... are not the usual equities of private litigation but public equities.") (citing *FTC v. Food Town Stores, Inc.,* 539 F.2d 1339, 1344 (4th Cir.1976)).

[63] ACL Opp. Mem. 14.

liability on that basis is right up there with the chance of the sun rising in the west.

A. The AT&T Connection

The scheme here at issue–the creation and marketing to web site operators of a system for using ANI billing to bill and collect for their wares, a system that appears to have included deceiving telephone line subscribers into believing that they are liable even for unauthorized use of their telephone lines to access Internet-borne pornography–has been the project of Robert Green and Marilyn Shein, both of whom have been held in contempt and are fugitives. ACL, like Verity, is simply one of the corporate vehicles they have employed[64] to perpetrate what, at first blush at least, seems in part to have been a very substantial swindle.[65] The fact is that the gravamen of the FTC's case is that the billing for access to the web sites *as if* the bills were for telephone service in some cases took advantage of consumers' well founded belief that they are responsible for paying for *telephone calls* made on their lines regardless of who made them–a premise that does not apply to services of the sort provided by ACL's customers. Thus, according to the FTC, ACL sought to benefit from a false impression created by the fact that it chose AT&T to do the billing. For ACL now to suggest that it has no liability because it arranged to have the bills printed, mailed and collected by AT&T is remarkably audacious–and remarkably devoid of

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[64] ACL was primarily owned and controlled by Green and Shein until September 2000, the entire period for which ACL's conduct is challenged by the Commission. Each owned 40 percent of ACL through other corporations. PX 143, at 33-34

[65] Of course, it appears that at least some of the consumers who received bills knew what they were getting into and were not deceived.

merit–whether AT& *282 T was a witting or an unwitting participant.

Further, ACL's attempt to cast blame on AT&T–which would not exculpate ACL even if AT&T also were culpable–is not very promising. The pivotal question in this regard is what AT&T knew and when it knew it–in other words, whether AT&T, when it billed consumers for telephone calls to Madagascar, knew that the consumers were really being asked to pay for access to web sites–videotext services–rather than simply telephone calls. This is critical because telephone subscribers are liable for any telephone calls made on their lines, regardless of who made or authorized them, but they are not liable for unauthorized use of those lines for videotext services. Evaluating this question requires consideration of the history of ACL's relationship with AT&T.

1. ACL's Agreement with Telecom Malagasy

The parties agree, for the purposes of this motion, that ACL entered into an agreement with Telecom Malagasy ("TM") in May 1997 in which TM assigned ACL the exclusive right to carry and terminate telephone calls to a range of numbers assigned to TM by international telephone authorities. TM directed all originating countries to make accounting payments for traffic on those numbers to ACL and to transmit or terminate all of the traffic on those numbers according to ACL's instructions.[66] ACL then contracted with information providers ("IPs") for the right to include the Madagascar numbers in their billing systems.[67]

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[66] Stipulation of Agreed Facts ("Stip.") ¶ ¶ 2-4.

[67] ACL Opp. Mem. 8.

2. The Contract Between ACL and AT&T

It is undisputed also that ACL, AT&T and AT&T U.K. (now Viatel) entered into an agreement in January 1999 for the carriage and termination of traffic to the Madagascar numbers assigned to ACL.[68] During a sixteen-month period, AT&T billed $30,618,447, from which it deducted charge backs of $11,268,778. The calls were billed according to AT&T's tariff filed with the FCC.[69]

ACL first argues that the contract with AT&T put AT&T on notice of what ACL was doing right from the outset. The contract refers to "switched voice services" between the United States and Madagascar and describes ACL as "hold [ing] a limited telecommunication license in Madagascar to terminate audiotext calls only."[70] It defines "Audiotex Calls" as "calls placed to telephone numbers in Operating Territory that are advertised or promoted in the U.S. for entertainment, fundraising or information provision purposes" by ACL or a third party who is compensated by ACL.[71]

Defendants promote a definition of audiotext that encompasses videotext, the material here involved, arguing from this premise that AT&T must have known what was going on.[72] It is unnecessary, however, to decide whether defendants' proposed definition is plausible, at least in some circumstances.

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[68] Stip. ¶ 35; DX 6.

[69] PX 128 ¶ 4.

[70] DX 6 pmbl.

[71] *Id.* ¶ 8.c.

[72] Tr., June 5, 2001, at 58 (audiotext "[i]n its broadest sense" encompasses data traffic).

The testimony of Stephen Bevens and John Ault, formerly *283 of AT&T and AT&T (U.K.), respectively, which the Court credits in this regard, makes it clear that the contract itself did not give AT&T notice that AT&T would be carrying and billing for videotext. Bevens testified at the June 5 hearing that when the service initially was negotiated, it was for voice services only and included no reference to videotext.[73] Ault, who signed the contract for AT&T (U.K.),[74] stated in his May 2001 declaration that he discovered that AT&T would be carrying data transmissions and not audiotext during the contractual relationship, implying that the contract had not made it clear.[75]

3. AT&T Discovers It Was Carrying Videotext

That the contract did not put AT&T on notice of the nature of ACL's activities does not answer the question of when AT&T tumbled to the nature of the traffic it was carrying. ACL claims that even if AT&T did not know from the contract itself, it learned that ACL was carrying videotext by virtue of explicit conversations and the fact that traffic was moved to uncompressed lines in January or February 2000. It relies principally upon testimony of Bevens and Ault.

In a May 2001 declaration, Bevens indicated that he spoke with Fox in January 2000 about the arrangement of Global Internet Billing ("GIB"), an information provider that marketed a dialer billing program with ACL's numbers, to terminate its traffic at ACL's Madagascar exchange numbers. Knowing that GIB's business was to sell dialers to information providers, he then realized, he claims, that AT&T was carrying videotext. In

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[73] *Id.* at 104-05.

[74] DX 6, at 14.

[75] DX 26 ¶ 3.

the same declaration, he says he spoke in February 2000 with AT&T's Consumer, Security and Public Relations divisions about AT&T transmission of data to the Madagascar numbers.[76] Moreover, he suggested that AT&T's security routinely tested suspect number ranges and, given the duration of calls, non-compressed lines, and modem sounds–all characteristic of data traffic–knew independently of these conversations that data was being transmitted.[77]

Bevens' testimony is not credible on this point. In his deposition, he testified that defendants never told him that they were beginning to offer videotext services,[78] that he and the defendants had discussed the appropriate disclosure for voice services only, and that neither he nor, to his knowledge, others at AT&T were aware that calls were being placed by a dialer program and were being short-stopped in the U.K.[79] The only reason he cited for this change between the deposition and the declaration was that he had had conversations with Ault, an employee, and defendants' lawyers.[80] Moreover, Bevens testified at the hearing that the conversation with Fox of GIB in which she made clear that data was being transmitted occurred shortly after he sent a letter to the telecom administration in

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[76] *See* DX 23 ¶ ¶ 4, 5.

[77] *See id.* ¶ 6.

[78] Defendants quibble that Bevens did not know when they *began* to offer videotext services but knew soon after, but the Court finds, especially in light of the follow up questions, that his answer should be understood more broadly.

[79] PX 150, attach. C, at 19, 27-28, 67.

[80] Tr., June 5, 2001, at 86-87.

Vanuatu, apparently another common destination for this type of traffic.[81] This letter was written on March *284 23, 2000.[82]

Nor is Ault's testimony any more persuasive on the timing issue. At the June 5 hearing, he described a surge in call volume that he thought probably occurred in February 2000 and that caused deterioration in call quality.[83] He testified that several conversations took place around that time with Green and AT&T (U.K.) personnel about the fact that data was being transmitted, but was unable to point to an event that coincided with the commencement of the discussions about data compression. When confronted with documentary evidence suggestive of a later date, however, he acknowledged that the conversations he referred to could have occurred in April.[84] His May 3, 2001, declaration is consistent with either version, as he there claimed that AT&T knew it was carrying videotext communications, but did not discuss timing.[85]

The e-mails shown to Ault are the most reliable evidence of the timing. They were sent on April 3 and 4, 2000 by Green and employees of AT&T, Viatel and GIB. An e-mail sent by Marilyn Fox of GIB on April 3, 2000, indicated that she had had a conversation with Ault about finding uncompressed lines for the Madagascar traffic.[86] On April 4, 2000, Stephen Kaczmarek of Viatel wrote to Ault about such routes and Green

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[81] Tr., June 5, 2001, at 98-99.

[82] AT&T Ex. O.

[83] Tr., June 5, 2001, at 54.

[84] *Id.* at 71.

[85] DX 26 ¶ ¶ 3-5.

[86] DX 12.

forwarded this e-mail to Fox, who replied to Bevens and Kaczmarek that the proposal "will help the data traffic flow."[87]

In all the circumstances, the Court finds that AT&T did not discover the nature of the traffic that it was carrying for ACL until some time in or after the first week in April, following which it promptly terminated ACL's contract.

B. Discussion

1. Likelihood of Success

The Court already has held the FTC has a fair and tenable chance of ultimately showing that ANI billing without an appropriate agreement with the line subscriber billed violates the FTC Act.[88] The jurisdictional and related defenses discussed above are unlikely to prove meritorious. The evidence at this stage indicates that ACL supervised website disclosures and contracted with dialer providers.[89] This amounts to more than mere provision of access to information, as defendants claim, and the FTC has a fair and tenable chance of showing that the services at issue were enhanced rather than basic.

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[87] AT&T Ex. N.

[88] *Verity I*, 124 F.Supp.2d at 199-204.

[89] *See* Blanchard Reply Decl. ¶ 7 (indicating that ACL's agreement with GIB is a "standard contract with an IP"); *id.* Ex.2 (same contract with GIB made in name of Western Connections Ltd. ("WCL") and indicating that WCL acts as a broker of "audiotex services" and provides equipment and facilities to support those services); PX 150, attach. A, at 23-24 (proposed addendum to GIB-WCL agreement submitted by "Marilyn" on ACL letterhead, requiring clients to provide WCL with "necessary disclaimers that will appear to the user of such programs"); PX 143, at 38 ("[WCL] does not trade and simply holds the relevant contracts with the IPs. Notwithstanding these contracts are held by WCL all payments made to IPs are transacted and recorded in ACL.") (KPMG expert report).

The issue, then, is whether the FTC is likely to show that ACL is responsible for this billing. From what has been said already, that is quite probable.

***285** For one thing, ACL shared the responsibility for billing during the Verity period. Green and Shein are or, at least, were the principals in both Verity and ACL. In the relationship with Integretel and its subsidiary eBillit, ACL and Verity were used interchangeably, with Verity substituted for ACL on the contracts at the last minute. [90] Similarly, when employees of GIB spoke with Green and Shein, it was not clear whether they were representing ACL, Verity, or Western Connections Limited, another corporation controlled by them.[91]

Moreover, based on the finding that AT&T, which performed the actual ANI billing for that early period, did not discover that it was carrying videotext until March or April 2000, the FTC is likely to succeed in showing that ACL had AT&T carry videotext and use ANI to bill consumers for this videotext without its knowledge for at least part of the pre-Verity period at issue. ACL contracted with videotext dialer providers, particularly GIB, with this purpose. The effort to shift responsibility to AT&T is weak also as regards the claim that AT&T "knowingly supplied its CIC number" to the dialer programs, not only because the CIC number is widely

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[90] PX 150, attach. B, at 604 (e-mail from Green to Greg Calgano) ("Our accountants have advised us to put the billing into one of our subsidiary companies. . . . [P]roduce the contract in the name of 'Verity International Ltd.' (VIL) and we can sign it today."); PX 150, attach. C, at 67-68 (drafts of contracts were in ACL's name).

[91] DX 32, at 86-88. Further blurring the lines between these corporate entities, WCL held the contracts with IPs, while all payments under these contracts were transacted and recorded in ACL. PX 143, at 38 (KPMG expert report).

available, but also because it was made available to ACL for the purposes of their contract.[92]

2. Equities

The reasoning of the Court's initial preliminary injunction opinion applies with equal force here.[93] The only difference lies in the fact that fifty percent of ACL now is owned by Oriel Communications, Ltd. ("Oriel"), a publicly traded Australian corporation with more than four thousand shareholders.[94] After emerging from bankruptcy proceedings, it acquired its interest in ACL on September 20, 2000. At that point, Green and Shein each went from owning forty percent[95] to owning twenty percent of ACL.[96]

The effect on Oriel's shareholders certainly is a concern, but it is mitigated by the fact that defendants are not enjoined from billing for their services in any form but can continue to bill with certain disclosures and notices to the line subscribers. Although Craig Burton, the Executive Director of Oriel, indicated that the extension of the injunction to ACL would

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[92] Tr., June 5, 2001, at 102.

[93] *Verity I,* 124 F.Supp.2d at 203.

[94] *See* Stip. ¶ ¶ 5, 8.

[95] The stipulation of agreed facts for the preliminary injunction hearing (paragraphs 14 and 19) conflicts with the application for ACL's 214 certificate, which lists Shein and Green as having fifty percent each, but the exact percentage is not crucial to this decision.

[96] Green and Shein are each eleven percent shareholders of Oriel. Green was a director of Oriel from August 18, 2000 to March 16, 2001, and Oriel's chairman of the board on October 27, 2000. Stip. ¶ ¶ 6, 7, 16, 21.

"inflict substantial damage on Oriel,"[97] Mark Blanchard, a director of ACL originally from Oriel, was equivocal about the effects that an asset freeze on ACL would have on ***286** Oriel. He testified at the June 5 hearing that it would "have an impact on Oriel, but, you know, we've just bought some further businesses in Oriel." [98]The damage to Oriel's shareholders is also offset in part by the renegotiation of the price Oriel paid for ACL. Initially it was to pay $8 million followed by another $4 million six months later.[99] When the Court entered a temporary restraining order against Verity and the individual defendants, Oriel renegotiated so that the second payment was reduced in amount and made contingent on future profits.[100] In all the circumstances, the equities weigh in favor of extending the preliminary injunction to ACL.

3. Delay in Seeking the Preliminary Injunction

[14][15] Defendants concede that the government generally is not subject to the defense of laches, but argue nonetheless that the FTC has waived the right to obtain a preliminary injunction against ACL because its delay in doing so has prejudiced Oriel, which invested in ACL.

The Second Circuit generally has followed *United States v. Summerlin*,[101] in which the Supreme Court held that the defense of laches is not available against a government

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[97] Burton Decl. ¶ 5.

[98] Tr., June 5, 2001, at 145.

[99] Burton Decl. ¶ 8.

[100] *Id.* ¶ 13.

[101] 310 U.S. 414, 416, 60 S.Ct. 1019, 84 L.Ed. 1283 (1940).

entity.[102] The Court need not decide whether there are exceptions, as defendants argue, because even if laches were applicable, the defense would be without merit here.

[16] "A party asserting the defense of laches must establish that: (1) the plaintiff knew of the defendant's misconduct; (2) the plaintiff inexcusably delayed in taking action; and (3) the defendant was prejudiced by the delay."[103] Here, prejudice is lacking because ACL and Oriel were on notice (with Green and Shein informed as to Verity), and Oriel was able to renegotiate the price it paid for ACL. Moreover, the FTC sought to extend the preliminary injunction six months after the case was filed and one month after adding ACL as a defendant. There was no inexcusable delay and no waiver.

4. Liability for Redress

[17] Defendants contend also that an asset freeze would be "legally unsupportable" because the FTC cannot obtain the restitutionary relief it ultimately seeks.[104] Defendants' argument, however, is without merit.

Contrary to defendants' argument, *FTC v. Five-Star Auto Club, Inc.*,[105] does not stand for the broad proposition that "the FTC [can] only obtain restitution from a particular defendant up to the amount of actual funds that the defendant received from illegal activities."[106] In that case, the court found that Angela Sullivan, the wife of the primary individual defendant,

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[102] *E.g., United States v. RePass,* 688 F.2d 154 (2d Cir.1982).

[103] *Ikelionwu v. United States,* 150 F.3d 233, 237 (2d Cir.1998).

[104] ACL Opp. Mem. 17.

[105] 97 F.Supp.2d 502 (S.D.N.Y.2000)

[106] ACL Opp. Mem. 17; *see also* Verity Opp. Mem. 10.

Michael Sullivan, was not personally involved in creating and disseminating the deceptive materials in issue and performed only ministerial tasks for the corporate defendant.[107] In light of this finding, the court limited Mrs. Sullivan's liability for consumer redress to the amount by which ***287** she had benefitted from the challenged activity.[108] In contrast, the court held the corporate defendant liable for the full amount of consumer loss[109] and held Michael Sullivan, deemed "the moving force behind the wrongful acts and practices of the corporation,"[110] jointly and severally liable with the corporate defendant.[111]

The *Auto Club* court's holding with respect to Angela Sullivan is completely inapposite to ACL's situation because it goes to the issue of individual liability for corporate practices.[112] Moreover, if anything, the *Auto Club* opinion is inconsistent with the defendants' argument regarding consumer redress. When addressing the corporate defendant's liability, it stated that "[t]he proper amount of relief is the full amount

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[107] *Five-Star Auto Club,* 97 F.Supp.2d at 539.

[108] *Id.*

[109] *See id.* at 534-35.

[110] *Id.* at 536.

[111] *See id.* at 537.

[112] *See id.* at 535 (setting out the standard for individual liability before addressing the issue of Mrs. Sullivan's liability); *see also FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564 (7th Cir.), *cert. denied,* 493 U.S. 954, 110 S.Ct. 366, 107 L.Ed.2d 352 (1989) ("Once corporate liability is established, the FTC must show that the individual defendants participated directly in the practices or acts or had authority to control them.").

lost by consumers."[113] Accordingly, ACL cannot avoid the asset freeze on the grounds that it did not receive the full amounts billed by AT&T.

IV.

Defendants motion for judgment on the pleadings is denied. Plaintiff's motion to modify the preliminary injunction to extend it to ACL is granted.

SO ORDERED.

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[113] *Five-Star Auto Club*, 97 F.Supp.2d at 534 (citing *FTC v. Febre*, 128 F.3d 530, 535-36 (7th Cir.1997), *FTC v. Gem Merch. Corp.*, 87 F.3d 466, 468 (11th Cir.1996), and *FTC v. U.S. Sales Corp.*, 785 F.Supp. 737, 753 (N.D.Ill.1992), *modified by* No. 91 C 3893, 1992 WL 104819 (N.D.Ill. May 6, 1992)).

APPENDIX D

UNITED STATES DISTRICT COURT,
S.D. NEW YORK.

No. 00 Civ.7422(LAK)

FEDERAL TRADE COMMISSION,

Plaintiff,

v.

VERITY INTERNATIONAL, LTD. *et al.*,

Defendants.

Dec. 13, 2000

MEMORANDUM ORDER

KAPLAN, District Judge.

Defendants operate a billing service for Internet pornographers. Web sites containing what defendants euphemistically refer to as adult content ascertain the telephone numbers from which visitors to the sites accessed the Internet through a system known as Automatic Number Identification ("ANI"). Defendants then bill the subscribers of those telephone numbers– who may or may not be the same persons who accessed the web sites– for access to the pornographic materials, although most of the bills here at issue described the services for which the bills were rendered as telephone calls to Madagascar. Defendants insist upon payment by line subscribers irrespective of whether the line subscribers used or authorized the use of their telephone lines to access the web sites of defendants' clients.

The Federal Trade Commission ("FTC" or "Commission") contends principally that defendants' insistence that line subscribers are legally obligated to pay for access to their clients' web sites, even where the line subscribers neither used them nor authorized *195 such use, violates Section 5(a) of the Federal Trade Commission Act (the "Act").[1] The matter now is before the Court on the FTC's motion for a preliminary injunction.

FACTS[2]

Verity International, Ltd. ("Verity")[3] bills and collects for access to materials offered by operators of sexually oriented web sites without requiring those who access the sites to provide a credit card number over the Internet. Although the system has undergone a number of changes over time, the core concept has been constant. A computer user employs his or her modem, telephone line and normal Internet service provider ("ISP") to connect to a web site operated by a Verity client. The user then is presented with a series of screens which

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[1] 15 U.S.C. § 45(a).

[2] As no party sought an evidentiary hearing, none was held. Tr., Oct. 30, 2000, at 36.

[3] Defendants asserted at oral argument that the Verity named in the complaint actually is the wrong entity, that it changed its name some time ago to Hamilton Telecommunications Ltd. ("Hamilton"), and that the correct entity is Verity International Ltd., a Bahamian company. Tr., Oct. 19, 2000, at 7-8. The two entities, however, appear to be under common ownership, as both appear to be owned by defendants Green and Shein. *See* Stipulation of Agreed Facts ("Stip.") ¶¶ 2, 4; PX 114; Green Decl., ¶ 1; Tr., Oct. 19, 2000, at 7-8. The point, however, is academic in view of the Verity Defendants' "assurance that in spite of the misjoinder, we have treated this [i.e., Hamilton] as the Verity International Company in the Bahamas, that it is subject to the court's jurisdiction and is complying with the TRO, not the Hamilton Communications entity." *Id.* at 8.

together purport to set forth terms and conditions of use. On the last of the screens, the user is presented with a box that states "I Agree."[4] If the user clicks that box, a dialer computer program is downloaded from the web site to the user's computer. The dialer program then automatically disconnects the user's computer modem from the user's ISP and reconnects the user's computer to the same web site by placing a call to an international telephone number assigned by the relevant country to a Verity affiliate, Automatic Communications Limited ("ACL").[5] The user then views the wares of Verity's client. Verity or an affiliate then uses the ANI system to ascertain the identity of the subscriber to whom the telephone line employed by the user is assigned, who may or may not be the user who agreed to use the web site, and bills the line subscriber for use of its client's web site, currently at the rate of $3.99 per minute.

THE ORIGINAL SYSTEM

Verity's system dates back to approximately 1999, when ACL and its agents (including Verity) worked out an arrangement with Telecom Madagascar ("TM"), the national telecommunications carrier for Madagascar, whereby ACL was appointed TM's agent for a series of telephone numbers allocated to Madagascar by international telephone authorities. Under the appointment, TM assigned to ACL the right to receive revenues from those numbers, the right to direct that payment for calls to those numbers be made to ACL or its designee rather than to TM, and the right to terminate calls to

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[4] For reasons that are far from apparent, the FTC has not contended that the disclosure contained on these screens is inadequate or misleading.

[5] As will appear, the placement of the call to the international telephone number does not necessarily mean that the call is connected to the country to which the number is assigned.

those numbers at any location that ACL desired, even at locations outside Madagascar.[6]

In January 1999, AT&T entered into an agreement with ACL and TM to handle call traffic to the Madagascar number range assigned to ACL and to bill the calls through regular monthly statements to customers in exchange for half of the revenue. *196 The charges appeared on customer telephone bills as charges for telephone calls to Madagascar telephone numbers although no calls ever were put through to Madagascar.[7]

By May 2000, ACL's call volume through AT&T had reached one million minutes per month. Although there is reason to believe that a substantial number of users refused to pay AT&T's bills for these services,[8] thus suggesting widespread consumer dissatisfaction, there is no need to resolve that issue for purposes of this motion.

VERITY ADOPTS DIRECT BILLING

In May 2000, AT&T terminated its agreement with ACL, which set out to make alternative arrangements. By July 2000, ACL had arranged to have Sprint Communications Company

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[6] TM evidently was willing to enter into this arrangement in exchange for a portion of the revenues generated.

[7] ACL arranged with British Telecom to "short stop" calls to its Madagascar numbers in London and to route them to servers operated by its clients, the providers of the pornographic material.

[8] AT&T billed approximately $30,618,447 and gave adjustments or charge backs (that is, money credited back to consumers) of $11,268,778 for connections to these Madagascar numbers during the period in which it carried these calls. See PX 128 ¶ 7.

handle the call traffic[9] and, after a brief period of billing through Sprint,[10] it decided to bill line subscribers directly (rather than through their telephone bills) and to transfer billing responsibility to Verity. Verity in turn contracted with Integretel, Inc. ("Integretel") to prepare[11] and mail the bills, collect payments, and answer a toll-free "customer service" number printed on the bills. Integretel involved its subsidiary, eBillit, Inc. ("eBillit") in these activities and subcontracted the job of handling billing inquiries.[12]

Verity began billing line subscribers on separate billing statements for use of its clients' web sites in the first week of September for July services. Shortly thereafter, it sent out a new round of bills for August. All told, it sent approximately 67,000 bills during the week of September 11 and another 44,000 bills during the following week.[13]

At the top of the bills sent to line subscribers appeared Verity's name and the address of a non-existent post office box[14] in San Jose, California. The address to which payments were directed was a different San Jose post office box registered to Integretel. The bills included a summary of charges and a chart of details about them--the date, time,

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[9] *See* Stip. ¶ 26.

[10] *See* DX 1.

[11] Integretel received information about each call (originating telephone number, destination, time and length of call) from Sprint in electronic format and matched the numbers with billing addresses supplied by local exchange carriers. Calcagno Decl. ¶ 6; DX 6.

[12] *See* Calcagno Decl. ¶ 9.

[13] PX 101, at 4.

[14] *See* PX 102, at 2 (statement of Postal Inspector Bonnie Bone).

destination (Madagascar), telephone number called, duration and charges per call. Under the heading "INTERNET BILLING," the first page stated that "THIS BILL ACCOUNTS FOR INTERNATIONAL CALLS, FROM YOUR MODEM TO A MADAGASCAR NUMBER, FOR WEBSITE ACCESS." On the bottom right, the bill read, "For questions about your invoice please call (800) 793-1418."[15]

DISASTER STRIKES

The implementation of Verity's new system was a disaster. Part of the problem, as the Verity defendants essentially admit,[16] was a customer service failure. Initially, only one telephone line was available *197 for line subscribers calling the 800 number with complaints and inquiries, and it quickly was overwhelmed so that calls were dropped or placed on hold indefinitely.[17] Customer service personnel were not adequately trained. Many pressured callers to pay the bills or told them that they had no other option.[18] Others were misdirected by directory services to an entirely unrelated company in California, which in turn directed the complaints to the FTC.[19] Those who tried to e-mail <info@verityinternational.com> instead of calling the 800 number had no more luck in getting a response: at least one received an e-mailed description of the

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[15] *See* PX 1-81.

[16] *E.g.*, Def. mem. in support of motion to vacate or modify the temporary restraining order, 6-8.

[17] *See, e.g.*, PX 2; PX 6; PX 11, at 1; see also DX 1, ¶ 17; DX 2, ¶ 18.

[18] *See, e.g.*, PX 1, at 2; PX 3, at 1.

[19] *See* PX 1, at 1; PX 7, at 1; PX 9, at 1; PX 10, at 1.

way the program is downloaded and a copy of a disclaimer.[20] But the customer service failure, in many ways, was the least of the problems.

The FTC received 548 complaints about Verity in the period September 18 through September 22, 2000.[21] The complaints were variations on a theme. Line subscribers said they had neither made nor authorized the calls: the computer at issue was in the line subscriber's possession and switched off at the time the calls allegedly were made;[22] a minor child in the household downloaded the program without authorization; [23] the line subscriber billed had both a 900 block and an international-call block on the line;[24] or the computer at issue was on-line with another web-based program at the time the call purportedly was made.[25] The FTC has submitted in support of this motion 81 declarations from recipients of these bills who assert that they did not access or authorize anyone to use their telephones to access the services for which Verity billed them.

Notwithstanding this evidence, the Verity defendants stoutly argue that every call for which they billed in fact was made from the line subscriber's line to the Madagascar numbers assigned to ACL and that Sprint's call records

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20 *See* PX 1, at 5, 9.

21 *See* PX 106, at 2.

22 *See* PX 1, at 1.

23 *See* PX 3, at 1.

24 *See* PX 9, at 1.

25 *See* PX 12, at 4.

indisputably so establish. The record at this point is insufficient to determine whether this is so, but in large measure the argument is beside the point. The record is more than sufficient to establish, and the Court finds, that a significant number of line subscribers to whom Verity sent bills did not themselves use, or authorize others to use, their lines to access the services of Verity's clients, even assuming that someone else used their lines to do so. And that is the critical factual premise of the FTC's position--that these defendants have engaged in unfair and deceptive practices by billing and insisting upon payment by line subscribers even where the line subscribers did not themselves agree to pay.

PRIOR PROCEEDINGS

The FTC commenced this action on October 2, 2000 against Verity, its principals Robert Green and Marilyn Shein, Integretel and eBillit. The amended complaint contains three claims for relief. Counts One and Two assert that defendants' express and implied representations that line subscribers whose telephones were used to access web sites are legally obligated to pay defendants for access irrespective of whether the line subscribers actually accessed or authorized the access of the web sites are false and deceptive, and unfair, respectively, and therefore violate Section 5(a) of the Act.[26] Count Three contends that defendants' practice of causing charges to appear on bills as charges for *198 calls to Madagascar, when the calls in fact terminated elsewhere, is deceptive and also violates Section 5(a). It promptly sought injunctive and other relief pursuant to Section 13(b) of the Act.[27]

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[26] Am. Cpt. ¶¶ 22-28.

[27] 15 U.S.C. § 53(b).

On the day the action was commenced, the Court granted the Commission's *ex parte* application for a temporary restraining order which, *inter alia*, enjoined defendants from continuing their billing practices and froze and ordered repatriation of assets of Verity, Green and Shein in order to ensure the Court's ability to grant effective relief. At a hearing on October 4, 2000 at which all parties were represented, the Court continued the restraining order. As counsel for the Verity defendants at the hearing was not authorized to agree to continuation of the restraining order pending hearing and determination of the motion for a preliminary injunction, the order was continued through October 17. On October 6, however, the Verity defendants consented to continuation of the restraining order pending the hearing and determination of the preliminary injunction motion,[28] and the argument of that motion was scheduled for October 30.[29]

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[28] Letter, Sean A. Moynihan to Court, Oct. 6, 2000; see Tr., Oct. 19, 2000, at 4.

> On December 1, 2000, the Verity defendants filed a document entitled "praecipe withdrawing consent to continue temporary restraining order pending disposition of preliminary injunction motion" which purported to withdraw their consent to continuation of the restraining order, effective December 11, 2000. Inasmuch as these defendants gave unqualified consent to continuation of the restraining order pending a decision on the pending motion, their purported withdrawal was ineffective. The issue, however, is academic, as the Court on December 8, 2000 once again continued the temporary restraining order pending this decision.

[29] The temporary restraining order, insofar as it applied to Integretel and eBillit, was vacated by agreement between those defendants and the Commission. *See* Order, Oct. 10, 2000.

Notwithstanding this agreement, the Verity defendants on October 18 moved to vacate the temporary restraining order, an application the Court heard on October 19. In substance, Verity took the position that it had adopted changes in its business methods which addressed all of the Commission's concerns save ANI based billing of line subscribers and offered to consent to a preliminary injunction requiring compliance with its newly announced practices. The Commission, however, rejected Verity's offer so the preliminary injunction motion and the motion to vacate were heard on October 30, 2000. The Verity defendants expressly waived an evidentiary hearing.[30]

DISCUSSION

I. The Narrow Scope of the Remaining Dispute

The scope of the dispute has narrowed since the institution of this action. The FTC asks the Court to enjoin defendants from representing that the line subscriber must pay for services that he or she did not expressly authorize and from misrepresenting the destination of any long distance call or the amount owed for services actually rendered. More specifically, it seeks an order prohibiting the Verity defendants from billing any line subscriber "without the express verifiable authorization from the line subscriber that he or she accepts or authorizes the purchase of such services."[31] In addition, it seeks an asset freeze, repatriation of assets and complete financial statements from defendants.

The Verity defendants have proposed their own form of "preliminary injunction." Their proposed order would continue

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[30] Tr., Oct. 30, 2000, at 35-36.

[31] Plaintiff's proposed order for preliminary injunction and other equitable relief, § II.

the freeze on collections from the September bills already frozen although it would give defendants access to future receipts.[32] *199 And it would permit them to continue ANI-based billing of line subscribers, without express verifiable authorization from the line subscriber that he or she accepts or authorizes the purchase of services, provided they adhere to certain terms and conditions which, they argue, would protect consumer interests.[33] But it does not dispute the proposition that the Commission is entitled to some appropriate relief. Thus, the principal remaining areas of significant dispute on this motion are whether and on what terms these defendants should be permitted to continue ANI-based billing of line subscribers without express verifiable authorization by the line subscribers and the scope of the asset freeze.

II. Standard for Preliminary Injunction

[1] The FTC may obtain a preliminary injunction "[u]pon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action

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[32] Defendants' proposed preliminary injunction pending expedited trial on the merits ("Def.Prop.Inj.") ¶¶ 2-3.

[33] Among the terms and conditions are the use of a new on-line disclosure statement, removal of references on bills to calls to "a Madagascar number," inclusion on bills of a statement that the line subscriber is not obliged to pay "[i]f someone uses your telephone line to access our service without your authorization," provision of clear and conspicuous information as to billing inquiries, and maintenance of an adequate call center for billing questions. Id. ¶ 1.

Defendants' proposed order, it might be noted, arguably would not enjoin them from using ANI-based billing of line subscribers even where defendants do not comply with their proposed terms and conditions, although this appears to have been a drafting oversight. See Tr., Oct. 30, 2000, at 31.

would be in the public interest."[34] The standard differs from that applicable to private applicants for such relief. "The intent is to maintain the statutory or 'public interest' standard which is now applicable, and not to impose the traditional 'equity' standard of irreparable damage, probability of success on the merits, and that the balance of equities favors the petitioner."[35] That is, the FTC does not have to show irreparable harm,[36] but the Court must (1) determine that the FTC has a fair and tenable chance of ultimate success on the merits[37] and (2) consider the equities.[38]

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[34] 15 U.S.C. § 53(b) (1994 & Supp.).

[35] H.R. CONF. REP. NO. 624, 93d Cong., 1st Sess. 18 (1973), reprinted in 1973 U.S.C.C.A.N. 2533.

[36] *See FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1233 (9th Cir.1999).

[37] *See United States v. Sun & Sand Imps., Ltd.*, 725 F.2d 184, 188 (2d Cir.1984); *FTC v. Lancaster Colony Corp.*, 434 F.Supp. 1088, 1090-91 (S.D.N.Y.1977).

[38] *See Lancaster Colony Corp.*, 434 F.Supp. at 1096 ("The equities to be weighed are not the usual equities of private litigation but public equities.") (citing *FTC v. Food Town Stores, Inc.*, 539 F.2d 1339 (4th Cir.1976)). There is some disagreement among circuits about the weight to be given private hardship. *Compare Food Town Stores*, 539 F.2d at 1346 (concluding that private equities "are not proper considerations for granting or withholding injunctive relief under § 13(b)"), with *FTC v. Univ. Health, Inc.*, 938 F.2d 1206, 1225 (11th Cir.1991) ("While it is proper to consider private equities in deciding whether to enjoin a particular transaction, we must afford such concerns little weight, lest we undermine section 13(b)'s purpose of protecting the 'public-at-large, rather than individual private competitors.' ").

III. ANI-based Billing of Line Subscribers

As noted, the FTC alleges that defendants violated and continue to violate FTC Act Section 5(a) by making the false and deceptive representation that line subscribers are legally obliged to pay for web-site access[39] and by unfairly billing line subscribers even if those subscribers did not access the site, download the dialing program, or authorize either action.[40] Based on the evidence now before the it, the Court finds that the FTC is likely to *200 succeed in showing that these practices are deceptive and unfair.

A. False and Deceptive Representations

[2] To establish that defendants violated FTC Act Section 5(a) by engaging in unfair or deceptive acts or practices in or affecting commerce,[41] the FTC ultimately must demonstrate a material representation, omission, or practice that is likely to mislead consumers acting reasonably in the circumstances.[42]

1. Legal Obligation to Pay

To prevail on its first claim for relief, the FTC must establish that (1) Verity's bills represented that line subscribers

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[39] *See* Am. Cpt. ¶¶ 22-24.

[40] *See id.* ¶¶ 25-28.

[41] 15 U.S.C. § 45(a) (1994 & Supp.).

[42] *See FTC v. Pantron I Corp.*, 33 F.3d 1088, 1095 (9th Cir.1994), *cert. denied*, 514 U.S. 1083, 115 S.Ct. 1794, 131 L.Ed.2d 722 (1995); *FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1029 (7th Cir.1988); *FTC v. Five-Star Auto Club, Inc.*, 97 F.Supp.2d 502, 526 (S.D.N.Y.2000) (McMahon, J.). The FTC does not have to prove that defendants intended their misrepresentations to defraud or deceive, or made them in bad faith. *See, e.g., World Travel Vacation Brokers*, 861 F.2d at 1029.

are legally obligated to pay irrespective of whether they used or authorized use of the services of defendants' clients, and (2) the representation was materially false or deceptive.

Although Verity's bills include the "Total Amount Due" and instruct consumers to detach and return a portion of the bill with payment, they do not state in so many words that the addressees are legally obligated to pay the sum claimed. Nevertheless, courts may not blind themselves to the common understandings of our society. One who tenders a bill thereby renders a statement of account.[43] The bill is a representation that the sum claimed in fact is due and owing and that the addressee is obliged to pay. Certainly recipients of bills ordinarily so understand, and the Court infers for purposes of this motion that this understanding is reasonable. Moreover, it is difficult to imagine a representation that would be more material, as the very point of a bill is to induce the recipient to rely on it and therefore to send defendants the money claimed. The only question of substance in this connection is whether defendants' bills, to the extent that they are sent to line subscribers who neither used nor authorized use of their lines to access the services of defendants' clients, are legally obligated to pay. If they are not, then the bills contained materially false representations.

[3] Of course, many are familiar with the proposition that the subscriber to a telephone line is legally obligated to pay the telephone company and long distance carrier for any calls made on that line. The source of that obligation, however, is not as

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[43] *Cf. LeBoeuf, Lamb, Greene & MacRae, LLP v. Worsham*, 185 F.3d 61 (2d Cir.1999) (explaining that, under New York law, the obligation to pay invoices must be based on a prior agreement to an account or might be implied if the party receiving the bill does not object within a reasonable time) (quoting *Chisholm-Ryder Co. v. Sommer & Sommer*, 70 A.D.2d 429, 431, 421 N.Y.S.2d 455, 457 (4th Dept.1979)).

well known. Typically, the relationship between the line subscriber and the telephone company and long distance carrier is governed by tariffs filed with the Federal Communications Commission ("FCC").[44] Such tariffs "conclusively and exclusively enumerate the rights and liabilities of the contracting parties."[45] They *201 not only govern a carrier's rates to various destinations, but also set forth customers' obligations and carriers' duties. Customers are presumed conclusively to have knowledge of these filed rates and obligations [46] and courts therefore consistently have held that line subscribers are obliged to pay for telephone calls they

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[44] Section 203(a) of the Act requires common carriers to file tariffs with the FCC and Section 203(c) makes it unlawful for a carrier to "extend to any person any privileges or facilities in such communication, or employ or enforce any classifications, regulations, or practices affecting such charges, except as specified in such schedule." 47 U.S.C. § 203(a), (c).

[45] *Marcus v. AT&T Corp.*, 138 F.3d 46, 56 (2d Cir.1998) (quoting *AT& v. New York City Human Res. Admin.*, 833 F.Supp. 962, 970 (S.D.N.Y.1993)); *see also AT&T v. City of New York*, 83 F.3d 549, 552 (2d Cir.1996) ("The legal relationship between AT&T and its customers is defined by the tariffs, which consist of the terms and conditions of the common carrier's service and rates, that AT&T is required to filed and maintain with the [FCC] under the FCA."); *cf. AT&T v. Cent. Office Tel., Inc.*, 524 U.S. 214, 118 S.Ct. 1956, 1964-65, 141 L.Ed.2d 222 (1998).

[46] *See, e.g., Maislin Indus., U.S. v. Primary Steel, Inc.*, 497 U.S. 116, 110 S.Ct. 2759, 111 L.Ed.2d 94 (1990); *Kansas City S. Ry. Co. v. Carl*, 227 U.S. 639, 653, 33 S.Ct. 391, 57 L.Ed. 683 (1913); *Marcus*, 138 F.3d at 63.

never authorized.[47] These principles are known as the filed rate doctrine.[48]

[4] Drawing implicitly on the filed rate doctrine, defendants argue that Verity is merely using ANI-based billing in a way that is common practice in the telecommunications industry. Defendants meet each of the FTC's consumer complaints and bills with a matching Sprint electronic code meant to demonstrate that the call indeed was placed as indicated on the bill. But the argument skips over a critical point.

The Court assumes arguendo that the calls, in all or most cases, in fact were placed from the line subscribers' telephones. But the filed rate doctrine would make the line subscribers responsible for those calls only if a filed tariff covering the particular line subscriber so provided. The FTC is likely to establish that this simply is not so.

The FCC long has distinguished between basic telecommunications carriage – principally ordinary telephone

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[47] *See, e.g., Am. Message Cents. v. FCC*, 50 F.3d 35 (D.C.Cir.1995) (denying petition to review FCC's determination that tariff required customers to pay for all completed calls); *New York Human Res. Admin.*, 833 F.Supp. at 962 (granting AT&T's motion for summary judgment in case of unauthorized access to the city's long-distance telephone service); accord, *AT&T v. Intrend Ropes & Twines, Inc.*, 944 F.Supp. 701 (C.D.Ill.1996); *AT&T v. Cmty. Health Group*, 931 F.Supp. 719 (S.D.Cal.1995); *AT&T v. Jiffy Lube Int'l, Inc.*, 813 F.Supp. 1164 (D.Md.1993).

[48] The filed rate doctrine originally was associated with the Interstate Commerce Act tariff provisions. *See, e.g., Maislin Indus.*, 497 U.S. at 116, 110 S.Ct. 2759. The Supreme Court has held that the filed rate doctrine applies to the Communications Act as well. *See Cent. Office Tel.*, 118 S.Ct. at 1956 (1998); *MCI Telecomms. Corp. v. AT&T Co.*, 512 U.S. 218, 229-31, 114 S.Ct. 2223, 129 L.Ed.2d 182 (1994).

and long distance service--and enhanced services such as those offered by Verity's clients.[49] In Amendment of Section 64.702 of the Commission's Rules and Regulations ("Computer II "), for example, the FCC declined to institute comprehensive regulation for enhanced services and found that vendors of enhanced services, defined as anything more than basic transmission service, were not engaged in common carrier activity.[50] The Telecommunications Act of 1996 likewise distinguishes between telecommunications services and information services,[51] stating that "a telecommunications *202 carrier shall be treated as a common carrier under this chapter only to the extent that it is engaged in providing telecommunications services."[52] While basic communications services long have been covered by filed tariffs, enhanced and information services have not. Thus, there appear to be no

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[49] Pl. mem. of points & authorities supporting motion for temporary restraining order and order to show cause, at 4.

[50] *See Amendment of Section 64.702 of the Commission's Rules and Regulations* ("Computer II "), 77 F.C.C.2d 384, 420, 0080 WL 233301 (1980) (defining "basic service" as the offering of "a pure transmission capability over a communications path that is virtually transparent in terms of its interaction with customer supplied information"), *recon.*, 84 F.C.C.2d 50 (1980), further recond., 88 F.C.C.2d 512 (1981), *aff'd sub nom. Computer & Communications Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C.Cir.1982), *cert. denied*, 461 U.S. 938, 103 S.Ct. 2109, 77 L.Ed.2d 313 (1983).

[51] *See* 47 U.S.C. § 153(46), (43) ("The term 'telecommunications' means the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."); *id.* § 153(20) ("The term 'information service' means the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications ....").

[52] *Id.* § 153(44) (defining "telecommunications carrier").

tariffs governing the rates or the terms and conditions upon which these services are offered. At any rate, defendants have pointed to none. In consequence, there appears to be no legal basis for defendants' contention that telephone line subscribers are legally obligated to pay charges for enhanced services accessed over their subscribed lines where the subscribers neither have accessed nor authorized access to those services. Indeed, the FCC has made clear that it is improper to rely solely on ANI as a basis for holding a line subscriber liable for information purchases made from his or her telephone line.[53]

In the absence of a legal obligation to pay based on the filed rate doctrine, the next question is whether a contract exists between the line subscriber and defendants. Assuming arguendo that clicking on "I accept" on the disclaimer screens forms a valid contract between the person who clicks and defendants or their clients, it suffices at this stage to note that basic contract principles provide that an offer and acceptance create a contract only between the offeror and the offeree. Indeed, where the person who accepts the offer is incompetent or a minor, the contract is voidable.[54] Accordingly, unless the line subscriber is the person who accepts the offer by clicking on the "I accept" box, there is no contract between the defendants or their clients, on the one hand, and the line subscriber, on the other.

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[53] 9 F.C.C.R. 2819 (1994); *see also* 9 F.C.C.R. 6891 (1994).

[54] *See, e.g., Petition of Yonnone*, 72 Misc.2d 579, 580, 339 N.Y.S.2d 212, 214 (Surr.Ct.Orange Co.1972) ("The general rule of law is that an infant has not the capacity to bind himself absolutely by contracts, since any contract made by him during his infancy may be avoided."); *see also* IE. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § § 4.2- 4.4 (2d ed. 1998 & Supp.2000).

The bills sent out in early September in substance represented that line subscribers were obliged to pay for services accessed over their lines without regard to whether the line subscribers accessed or authorized access to the services. Insofar as these bills were sent to line subscribers who did not access or authorize access to the services for which payment was sought, the FTC is likely to establish that the bills made false and deceptive representations of material fact in suggesting that the line subscribers were obliged to pay the bills.

2. Call Routing

The facts underlying the FTC's third claim, that defendants violated Section 5(a) by billing consumers for telephone calls to Madagascar when the calls actually terminated in other countries with lower telephone rates, are not disputed. Defendants concede that the calls, "identified on the bills as being for calls 'to a Madagascar number, for website access'" were "actually terminated on a server located in London."[55] Also, the disclosure on the client web sites as it existed at the time the FTC's investigation began stated, arguably in misleading fashion, that "[i]nternational long distance telephone charges apply" and that "[y]our phone bill will reflect the charges as shown above on a per minute basis for the cost of the call."[56] It is unnecessary, however, to reach even tentative conclusions about this practice at this stage in view of defendants' representation that they will cease making any such references *203 in the event the Court permits them to resume billing.

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[55] Motion to vacate or modify the temporary restraining order, at 3, 11.

[56] *See* PX 101, at 6.

B. Unfair Practices Claim

[5] The second count of the FTC's amended complaint challenges the ANI-based billing, as applied to line subscribers who have not used or authorized the use of the services offered by Verity's clients, as an unfair trade practice, also in violation of Section 5(a) of the Act. An act or practice is unfair if it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."[57]

The FTC has established that it likely will prove at trial that a significant number of line subscribers already have been billed without having made or authorized the calls, a substantial injury to these consumers. Defendants nevertheless contend that there has been no unfair trade practice because line subscribers reasonably may protect themselves against such injury by controlling access to the telephone lines over which their clients have been accessed. But the Court is not prepared to accept that assertion, at least at this point. For one thing, there is credible evidence that at least some line subscribers who have 900 number or long-distance blocks on their telephone lines nevertheless have been billed by defendants, thus suggesting that such blocking measures are imperfect. Further, at least at this preliminary stage, this Court finds that the Commission is likely to establish that avoiding misuse of their telephones by children of line subscribers and others with access to their lines imposes an unreasonable burden on many consumers, especially in comparison with the easy alternative sought by the Commission--a bar on imposing liability on line subscribers absent a verifiable agreement to be responsible for the charges.

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[57] 15 U.S.C. 45(n) (1994 & Supp.).

The defendants argue also that consumers benefit from having an alternative to disclosing credit card information on the Internet. As a broad proposition, that probably is so.[58] Nevertheless, it does not carry the day, at least at this stage. Surely the availability of this alternative does not benefit line subscribers who do not use the service in the first place. On the contrary, they are victimized by the creation of a means that permits unauthorized users to shift costs from themselves to the line subscribers whose lines they abuse. Moreover, while the Court recognizes that defendants would be harmed by an order that effectively would require them to make pre-subscription agreements with line subscribers before charging them for their clients' services on an ANI-based basis, that harm is insufficient to tip the scales. The practical reality here is that many consumers who receive bills simply pay them. Others are not willing to engage in extended debates with billers, as they lack the time or energy or simply are fearful that an alleged creditor will damage their credit ratings and thus limit their access to credit unless they pay as demanded. The harm of which defendants complain would be the product of preventing defendants from capitalizing on the inattention and fear of consumers or on the disparity of power between them and the persons they bill to extract payments which, in many cases, probably are not rightfully theirs.

Defendants contend, finally, that they have an enormous universe of happy customers, claiming that during the period in which they billed through AT&T they had uncollectible charges of less than three percent.[59] But the evidence submitted by AT&T demonstrates that more than 35 percent of defendants'

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[58] There probably also are consumers who benefit from defendants' service by concealing the nature of their on-line activities from others by means of the deceptive bills.

[59] *See* DX 1 ¶ 11.

charges from January *204 1999 through September 2000 were uncollected,[60] a figure far in excess of the charge back levels experienced by online retailers and credit card companies.[61] This certainly suggests that there was dissatisfaction with defendants' activities even during the period when their charges misleadingly appeared on bills as fees for fictional telephone calls to Madagascar.

In all the circumstances, the Court holds that the Commission is likely to establish that defendants' ANI-based billing of line subscribers who have not themselves used or authorized use of defendants' clients' services is an unfair trade practice.

IV. Individual Liability

The FTC is entitled to relief against the individual defendants, Green and Shein, on a showing that they participated in Verity's wrongful acts or that they had the authority to control Verity and knew of the acts or practices.[62] The FTC is likely to succeed in establishing the personal liability of Green and Shein in this case. They are partial owners of Verity and directors of ACL.[63] Green's declaration establishes his intimate involvement with the activities here at issue.[64] When the late September disaster struck, Shein went to the call center in Florida handling the complaint calls to

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[60] PX 129.

[61] *See* PX 130, at 2.

[62] *See FTC v. Amy Travel Serv., Inc.*, 875 F.2d 564, 573 (7th Cir.), *cert. denied*, 493 U.S. 954, 110 S.Ct. 366, 107 L.Ed.2d 352 (1989); *FTC v. Five-Star Auto Club, Inc.*, 97 F.Supp.2d 502, 535 (S.D.N.Y.2000

[63] *See* Stip. ¶¶ 2, 4, 6.

[64] *See* DX 1.

instruct the subcontractor's staff on responding to the 800 number listed on Verity's bill.[65] The preliminary injunction therefore appropriately reaches Green and Shein as well as Verity.

V. Relief

As noted, defendants effectively concede that the Commission is entitled to some injunctive relief. They propose, however, to continue to use ANI-based billing, but to provide improved disclosure on client web sites, to give post-bill concessions to consumers who complain about their bills, to permit injured consumers to block access to web sites using defendants' billing mechanism, and to post a $1 million bond as security for injured consumers while leaving the funds previously collected and frozen pursuant to the restraining order restrained. The Commission objects that these measures are insufficient.

A. ANI-Based Billing

The fundamental point of contention is whether these defendants should be permitted to use ANI-based billing of line subscribers during the pendency of this litigation. Given the Court's provisional conclusion that this practice, as defendants employ it, is likely to be found to violate the Act, one's initial reaction may well be negative. But the question is more difficult.

Courts of equity must bear in mind that preliminary injunction rulings are based on incomplete records and therefore arguably have a higher probability of error than rulings after trial or on summary judgment. Moreover, the relief sought here would have a drastic adverse impact on the

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[65] *See* Calcagno Decl. ¶ 9c.

defendants' business. In consequence, the Court is reluctant to impose what might be a commercial death sentence at an interlocutory stage if there is some reasonable alternative.

The chief vice of the defendants' ANI-based billing is that it falsely represents to line subscribers that the line subscribers are responsible for services purchased from defendants clients even where the line subscribers neither purchased nor authorized the purchase of those services. Defendants propose to address this problem *205 by using an improved disclosure statement on client web sites, by the adoption of liberal policies for dealing with customer complaints, including an undertaking not to insist on payment by those line subscribers who contend that they did not purchase the services in question, and by a disclosure statement on its bills.[66] This proposal, however, is not adequate. Improved disclosure on web sites is desirable, but simply does not address the fact that the core of the problem here is that line subscribers often are not the persons who access the web site and therefore will not see even improved disclosure. More liberal complaint policies also are desirable, but they do not deal with the fact that defendants still would take advantage of deception of some consumers, who would not complain even where they would have every right to do so. And defendants' proposed disclosure statement would not go far enough. There is, however, a middle ground between defendants' rather tepid proposals and the Commission.

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[66] Defendants have proposed including a disclaimer on the bill indicating that "If someone uses your telephone line to access our service without your authorization, you will not be obligated to pay. If you suspect unauthorized activity contact us by (1) email at *<admin @verityinternational.com >*, or (2) our customer service toll free line at 1(800) 793-1418. We will then put a block in place so that our service cannot be accessed from your telephone line." Def. Prop. Inj. ¶ 1.a.iii.

At oral argument, defendants indicated that they would be prepared to accept a requirement of an explicit disclosure on their bills stating in substance that the line subscriber has no legal obligation to pay the bill unless the line subscriber personally agreed or authorized another to agree to do so.[67] Such a statement, if combined with improved disclosure, with other changes the defendants have proposed, and with a convenient method by which the line subscriber who did not use or authorize use of the services might have the bill withdrawn,[68] would protect consumers adequately during the pendency of the litigation. Accordingly, the FTC's motion for a preliminary injunction barring ANI-based billing is granted to the extent that defendants will be enjoined from engaging in ANI-based billing of any line subscriber unless (a) the line subscriber previously entered into an express verifiable agreement authorizing such billing, or (b) the bill conspicuously contains an express statement that the line subscriber is not obliged to pay the bill unless he or she personally agreed or authorized another to agree to pay for the services for which the bill is rendered and provides a convenient method by which a line subscriber who claims not to have done so may have the bill canceled.[69] The precise

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[67] Tr., Oct. 30, 2000, at 20-21.

[68] Defendants might provide a toll-free number which the line subscriber might call and/or a postage paid reply form on which the line subscriber simply could check a box to have a bill canceled.

[69] There is potential for abuse by line subscribers who use the service and then falsely disclaim use to avoid paying for it. The potential, however, is limited by defendants' ability to cut off service to any line subscriber who claims that he or she did not authorize the charges appearing on a bill. Moreover, even had defendants not agreed to the use of this mechanism, the imposition of this risk would have been entirely reasonable, as it is far less onerous than the alternative--a flat prohibition of ANI-based billing absent pre-subscription agreements.

details, including the layout and typography of an approved form of bill, will be worked out in the settlement of the preliminary injunction.

B. Asset Freeze

[6] The Commission seeks, among other things, restitution, refund of monies paid, and disgorgement of gains reaped by defendants through their alleged violations of the Act. Section 13(b) does not explicitly refer to these forms of relief. Nevertheless, courts have held repeatedly that the district court may exercise the full range of equitable remedies as incident to its power to grant injunctive relief sought by *206 the FTC under Section 13(b).[70] It is appropriate, therefore, for the Court to consider an asset freeze as "ancillary relief necessary to accomplish complete justice" under this section.[71]

Although the amended complaint is not entirely clear, it does not seem to be limited to the period since Verity started billing line subscribers directly, but to take in its activities in the earlier period during which it billed more than $30 million

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[70] *See, e.g., FTC v. World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1024-26 (7th Cir.1988); *FTC v. United States Oil & Gas Corp.*, 748 F.2d 1431, 1434 (11th Cir.1984) (per curiam); *FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1113 (9th Cir.1982) ("Congress, when it gave the district court authority to grant a permanent injunction against violations of any provisions of law enforced by the Commission, also gave the district court authority to grant any ancillary relief necessary to accomplish complete justice because it did not limit that traditional equitable power explicitly or by necessary and inescapable inference."); *FTC v. Southwest Sunsites, Inc.*, 665 F.2d 711, 718 (5th Cir.), *cert. denied*, 456 U.S. 973, 102 S.Ct. 2236, 72 L.Ed.2d 846 (1982); *FTC v. Five-Star Auto Club, Inc.*, 97 F.Supp.2d 502, 533 (S.D.N.Y.2000); *cf. SEC v. Cavanagh*, 155 F.3d 129 (2d Cir.1998) (holding that the district court appropriately granted an asset freeze sought by the SEC).

[71] H.N. Singer, 668 F.2d at 1113.

through AT&T and, briefly, billed through Sprint.[72] Hence, the preliminary injunction seeks a freeze for two reasons– to ensure that the Commission will be able to obtain restitution for prior alleged wrongdoing and to protect customers who may be injured in the future.

Defendants propose to address the Commission's concern by allowing the freeze to remain in effect with respect to sums collected pursuant to the bills Verity, through Integretel, sent out prior to the entry of the temporary restraining order[73] and by posting a $1 million bond. But this would be grossly inadequate. In view of the fact that defendants billed over $30 million through AT&T, about $19 million of which was collected, defendants' exposure here, in the event the Commission prevails, significantly exceeds $1 million in addition to the monies collected pursuant to the September bills. Moreover, as all of the Verity defendants are foreigners, there is a risk that any monetary judgment the Court ultimately might render could prove uncollectible.

Insofar as future billings are concerned, the need for a freeze is modest. If defendants elect to proceed with pre-subscription agreements with line subscribers, there presumably will be no basis for ordering restitution with respect to future collections. Restitution exposure, if any, should be very small even if defendants proceed without pre-subscription agreements because the statement the Court

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[72] Tr., Oct. 4, 2000, at 19-20.

[73] As of October 2, 2000, the amount frozen was $543,239.03. As Verity billed approximately $30 million through AT&T and more than $10 million for calls made in July and August, the amount presumably now is greater.

will require on future bills ought to provide adequate protection to most consumers.

Accordingly, the injunction will provide for a freeze of all sums collected pursuant to the September bills and will require either the posting of a bond in an amount (to be determined upon settlement of the order) substantially greater than $1 million or, alternatively, will extend the freeze to all or part of future collections and require repatriation of the assets of the Verity defendants. In any case, defendants will be required to make full and truthful disclosure of their financial conditions.

CONCLUSION

The Commission's motion for a preliminary injunction is granted to the extent indicated above. The foregoing constitute the Court's findings of fact and conclusions of law pursuant to Fed. R. Civ. P. 52(a). The Commission shall file and serve defendants with its proposed form of preliminary injunction on or before December 18. *207 Defendants shall file and serve plaintiff with any response on or before December 21 The Court will hear argument on the form of the injunction and any related issues on December 22 at 10:30 a.m. The temporary restraining order will remain in effect until the preliminary injunction is issued and filed.

SO ORDERED.

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
THURGOOD MARSHALL U.S. COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

Roseann B. MacKechnie
CLERK

Date:	6/7/06
Docket Number:	04-5487-cv
Short Title:	Federal Trade Comm. v. Verity Intl. Ltd.
DC Docket Number:	00-cv-7422
DC:	SDNY (NEW YORK CITY)
DC Judge:	Honorable Lewis Kaplan

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, Foley Square, in the City of New York, on the day of June two thousand six.

FILED: JUNE 14, 2006

FEDERAL TRADE COMMISSION
v.
VERITY INTERNATIONAL

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellants Verity International, et al. Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

For the Court,

Roseanne B. MacKechnie, Clerk
By: /s/_____
Motion Staff Attorney

APPENDIX F

U.S. Department of Justice

United States Attorney
Southern District of New York

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100 Church Street
New York, New York 10007

March 11, 2002

BY HAND

Honorable Lewis A. Kaplan
United States District Court
Southern District of New York
United States Courthouse
500 Pearl Street Room 1310
New York, New York 10007

Re: Federal Trade Commission v. Verity Int'l Ltd et al
00 Civ. 7422 (LAK)

Dear Judge Kaplan:

On behalf of the Federal Communications Commission ("FCC"), we respectfully submit this letter brief *amicus curiae* in response to the Court's January 13, 2002 Order. In that Order, the Court asked the FCC to address four issues that have arisen in connection with the allegations by plaintiff Federal Trade Commission against defendant Automatic Communications Ltd. ("ACL"). For purposes of answering the Court's questions, the FCC has accepted as true ACL's descriptions of its own business activities. The questions are answered in the order in which they were presented.

1. Is ACL a common carrier within the meaning of the Communications Act of 1934, as amended?

Under the Communications Act of 1934 (the "Communications Act"), the FCC has regulatory responsibilities regarding common carriers under Title II. 47 U.S.C. §§ 201-227. The Communications Act does not define "common carrier" other than as "any person engaged as a common carrier for hire." 47 U.S.C. § 153(10). The FCC's regulations provide that a communication common carrier is "any person engaged in rendering communication service for hire to the public." 47 C.F.R. § 21.2 (2000). Courts interpreting these provisions have set out a two-part test to determine whether an entity is a common carrier. First, the "the primary *sine qua non* of common carrier status is a quasi-public character, which arises out of the undertaking to carry for all people indifferently." National Association of Regulatory Utility Commissions v. FCC ("NARUC II"), 533 F.2d 601, 608 (D.C. Cir. 1976); Southwestern Bell Telephone Company v. FCC, 19 F.3d 1475, 1480 (D.C. Cir. 1994). The second prerequisite is "that the system be such that customers transmit intelligence of their own design and choosing." NARUC II, 533 F.2d at 609 (citation omitted).

An entity may be a common carrier for some activities but not others. NARUC II, 533 F.2d at 608. "Whether an entity in a given case is to be considered a common carrier or a private carrier turns on the particular practice under surveillance." Southwestern Bell, 19 F.3d at 1481. Thus, for example, a company may offer certain telecommunications services on a common carrier basis (basic telephone service), but may offer other services on a limited, customer-specific, non-common carrier basis (dark fiber-optic communication). See id. Consequently, the fact that ACL obtained a license pursuant to section 214 of the Communications Act and filed a tariff with the FCC is not determinative of the question of

whether ACL acted as a common carrier in connection with the practices at issue here.

Accordingly, to determine whether ACL is a common carrier, an analysis of ACL's specific business activities is the necessary first step. According to a director of ACL, ACL's business consists of three activities:

> (a) it obtains the right to certain telephone numbers in various countries; (b) it licenses the use of those numbers to companies that market billing software to website operators; and (c) it agrees with long distance carriers to terminate calls from the long distance company's home country to the numbers from the other countries.

Reply Declaration of Mark Blanchard, dated April 24, 2001, ¶ 3. Specifically with respect to the activities at issue here, ACL entered into three agreements. First, ACL entered into an agreement with Telecom Malagasy, the Madagascar telephone company, to be its agent for certain specified telephone numbers. Id. ¶ 5 & Ex. 1. Second, ACL licensed the Madagascar numbers to various Information Providers to use in their billing products marketed to website operators. Id. ¶ 6. Third, ACL entered into an agreement with AT&T, and a transit carrier, to terminate calls from the United States to the Madagascar numbers.[1] Id. ¶ 10 & Ex. 3. According to ACL, during the AT&T period, ACL did not operate any adult website, contract with website operators, provide dialer software for any website, communicate with consumers in the United States, set prices for videotext services for United States

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[1] ACL subsequently entered into a similar agreement with Sprint. For purposes of this response, however, the FCC has focused on the AT&T period, which was the subject of the preliminary injunction hearing held by the Court on June 5, 2001, and for which the record is most fully developed.

customers, prepare, send or collect bills for such services to or from United States consumers. Id. ¶ 4.

The FCC does not believe that ACL's activities constitute an offering of common carrier service to the public. They do not satisfy the two-part test set forth above. As the FCC has previously stated, "[t]he ultimate test is the nature of the offering to the public." Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities ("Resale and Shared Use Order"), 60 F.C.C.2d 261, ¶ 101 (1976), aff'd on reconsideration, 62 F.C.C.2d 588 (1977), aff'd sub nom AT&T v. F.C.C., 572 F.2d 17 (2d Cir.), cert. denied, 439 U.S. 875 (1978). ACL did not hold itself out to the public as an indifferent provider of telecommunications services. It was AT&T, not ACL, that provided long distance service to the public as a common carrier. ACL did not set the rates, or terms and conditions for long distance service. Nor did it bill customers for its services or take payment from them. In the Matter of Philippine Long Distance Telephone Company v. USA Link, 12 F.C.C.R. 12,010, at ¶ 17, 1997 WL 458228 (1997) provides an instructive contrast. In that case, the FCC found that Global Link, a company providing call-back international long distance service to Philippine customers, was holding itself out as a common carrier. The Commission relied on various factors, including the use of Global Link's name and logo in promotional material, the fact that Global Link set the rates, terms and condition for its services, the fact that Global Link's name appeared on the invoices sent to customers, and that customers were instructed to make payment directly to Global Link. Id. at ¶¶ 18-21. Thus, Global Link, unlike ACL, held itself out "prominently to its Philippine customers and agents as the provider of international services using call-back." Id. ¶ 21.

It also appears that to the extent ACL may have provided transmission services on a common carrier basis, those services were outside the jurisdiction of the FCC. Of ACL's three activities, only its conduct as a terminating carrier as agent for Telecom Malagasy is even arguably common carrier activity. As such, ACL accepted transmission of calls originating in the United States from a transit carrier in the United Kingdom and terminated the calls overseas. AT&T was the United States carrier and AT&T's tariff rates applied. See Blanchard Dec. ¶ 11; Affidavit of James H. Bolin, Jr., dated October 11, 2000, ¶¶ 3-4; Transcript of Hearing, June 5, 2001 at 53 (testimony of John Ault). ACL, in contrast, did not provide transmission service in the United States. ACL stood in the shoes of Telecom Malagasy – a foreign terminating carrier, not a common carrier subject to the FCC's jurisdiction. See 47 U.S.C. § 152 (a) (the Communications Act applies "to all interstate and foreign communications by wire or radio . . . which originates and/or is received within the United States); Cable & Wireless P.L.C. v. FCC, 166 F.3d 1224, 1229-30 (D.C. Cir. 1999) (noting that FCC "claims no authority to directly regulate foreign carriers" and holding that because order does not regulate foreign carriers or foreign telecommunications, it does not violate the Communications Act).

ACL has suggested that it is a reseller and, as such, a common carrier. The FCC does not believe that ACL was acting as a reseller with respect to the activities at issue in this matter. Resale has been defined as "an activity wherein one entity subscribes to the communications services and facilities of another entity and then reoffers communications services and facilities to the public (with or without 'adding value') for profit." Resale and Shared Use Order, 60 F.C.C.2d at ¶ 17; See also National Communications Assoc., Inc., v. AT&T, 46 F.3d 220, 221 (2d Cir. 1995) (reseller is "one who engages in the

business of purchasing long-distance telecommunications services at large-volume rates from a supplier, such as AT&T, and resells those services to others whose volume of use individually would not qualify them to purchase directly from the supplier").

It does not appear from the description of ACL's business activities that ACL ever subscribed to long distance serve and then resold that service to third parties. The only thing ACL resold was the right to terminate calls to certain Madagascar numbers. See Transcript of Hearing, June 5, 2001 at 134-35 (testimony of Mark Blanchard) ("ACL basically was a seller of the 2617 termination"); Blanchard Dec. Ex. 3 (co-carrier interconnection agreement, not a contract to purchase bulk AT&T services). ACL did not offer this service to the general public indifferently. Rather, ACL offered the service only to a limited group of Information Providers to whom ACL licensed the Madagascar numbers it obtained through its agreement with Telecom Malagasy. Accordingly, ACL's business activities do not appear to constitute common carrier activities under the Communications Act.

2. Assuming that it is, are its alleged activities with respect to which the Federal Trade Commission seeks relief in this action exempt from the Federal Trade Commission Act (the "Act") by virtue of the common carrier exemption in Section 5 (a) (2) of the Act?

The Federal Trade Commission Act, 15 U.S.C. § 45 (a)(2), exempts "common carriers subject to the Acts to regulate commerce." 15 U.S.C. § 44 defines "Acts to regulate commerce" to include the Communications Act. As set forth above, the FCC does not believe that ACL acted as a common carrier under the Communications Act in connection with the activities with respect to which the Federal Trade Commission seeks relief. The FCC takes no position with respect to the

interpretation of Section 5 (a) (2) of the Federal Trade Commission Act, 15 U.S.C. § 45 (a) (2).

3. Should the Court dismiss or stay all or any part of the action in favor of the FCC under the doctrine of primary jurisdiction?

The FCC does not believe the Court should dismiss or stay this action under the doctrine of primary jurisdiction. The doctrine of primary jurisdiction "allows a federal court to refer a matter extending beyond the 'conventional experiences of judges' or 'falling within the realm of administrative discretion' to an administrative agency with more specialized experience, expertise, and insight." National Communications Ass'n, Inc. v. AT&T, 46 F.3d 220, 222-23 (2d Cir. 1995) (quoting Far East Conference v. United States, 342 U.S. 570, 574 (1952)). Although there is "no fixed formula" to determine whether an agency has primary jurisdiction, National Communications Ass'n, 46 F.3d at 223, courts will generally consider four factors:

> (1) whether the question at issue is within the conventional experience of judges or whether it involves technical or policy considerations within the agency's particular field of expertise; (2) whether the question at issue is particularly within the agency's discretion; (3) whether there exists a substantial danger of inconsistent rulings; and (4) whether a prior application to the agency has been made.

Id. at 222.

The FCC does not believe that the case requires the FCC's specialized experience and expertise. At issue in this matter is whether ACL's role in a billing scheme constituted a deceptive trade practice within the meaning of the Federal Trade

Commission Act. This issue neither falls within the FCC's expertise, implicates any technical or policy considerations within the FCC's unique expertise, nor raises any question particularly within the FCC's discretion, that would warrant a dismissal or stay under the doctrine of primary jurisdiction. See National Communications Ass'n, 46 F.3d at 223-24. Compare LO/AD Communications v. MCI Worldcom, 2001 WL 64741 (S.D.N.Y. Jan. 24, 2001) (staying case under doctrine of primary jurisdiction in favor of proceeding before the FCC on issue of whether common carrier had violated provisions of the Communications Act).

4. Does the filed rate doctrine bar all or any part of this action?

The FCC does not believe that the filed rate doctrine bars all or any part of this action. Under the filed rate doctrine, no one may bring a judicial challenge to the validity of a filed tariff. Brown v. MCI Worldcom Network Services, Inc., 277 F.3d 1166, 1170 (9th Cir. 2002). Here, however, as in Brown, the validity of the tariffs applied is not in issue, either directly or indirectly. The purpose of the doctrine is "to ensure that the filed rates are the *exclusive source* of the terms and conditions by which the common carrier provides to its customers the services covered by the tariff." Id. at 1166 (citations omitted). In this case, as discussed above, ACL does not appear to be a common carrier, and therefore, the filed rate doctrine would not insulate the company from challenges to its alleged role in a deceptive billing scheme.

Thank you for your consideration of this submission.

Respectfully,

James B. Comey
United States Attorney

By: /s/_____
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